Docket:	:	A.15-07-015
Exhibit Number	:	ORA - ____
Commissioner	:	Catherine Sandoval
Administrative Law Judge	:	Jeanne McKinney
ORA Witness	:	James Simmons

ORA
OFFICE OF RATEPAYER ADVOCATES

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CALIFORNIA PUBLIC UTILITIES COMMISSION

REPORT ON SPECIAL REQUESTS 1 & 2 (DISTRICT CONSOLIDATION & RSF PROGRAM), 5, 11, 17 & 23 (SELECTED BALANCING AND MEMORANDUM ACCOUNTS)

California Water Service Company
Test Year 2017 General Rate Case
A.15-07-015

San Francisco, California
March 2016

MEMORANDUM

This Report on Special Requests 1 & 2 (District Consolidation and RSF Program), 5, 11, 17 & 23 (selected balancing and memorandum accounts) for California Water Service Company GRC A.15-07-015 is prepared by James Simmons of the *Office of Ratepayer Advocates (ORA) - Water Branch,* and under the general supervision of Program Manager Danilo Sanchez, and Program & Project Supervisors Lisa Bilir and Ting-Pong Yuen. Mr. Simmons' Statement of Qualifications is in Chapter 7 of ORA's Company-Wide Report on Results of Operations. Kerriann Sheppard and Christa Salo serve as ORA legal counsels.

Report on Special Requests 1, 2, 5, 11, 17 & 23

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CHAPTER 1: SPECIAL REQUESTS. 1 & 2 – AFFORDABILITY AND DISTRICT CONSOLIDATION, AND PHASING OUT THE RATE SUPPORT FUND PROGRAM

A. INTRODUCTION

This section addresses CWS's proposal to consolidate certain districts regionally, spread regional costs over larger customer bases, and phase out the Rate Support Fund Program (RSF.)[1] Additionally, ORA herein responds to CWS's proposal to terminate its RSF program if the Commission adopts CWS's proposed consolidations.

CWS proposes to consolidate the following existing districts into regional districts for rate making purposes[2]:

- Northern Region –Oroville, Marysville, Willows and Chico
- Bay Area Region – Redwood Valley (Lucerne, Unified, Coast Springs) and Bayshore
- Kern County Region – Kern River Valley and Bakersfield
- Los Angeles County Region – Antelope Valley (Lancaster, Leona Valley, Fremont Valley, Lake Hughes) and Palos Verdes
- Monterey Region –King City and Salinas

B. SUMMARY OF RECOMMENDATIONS

ORA makes the following recommendations:

1. The Commission should deny CWS's requests for district consolidations because they are not in the public interest.

[1] In its Testimony, CWS does not present a specific plan to phase out the RSF Program.

[2] CWS Direct Testimony Book, p. 124.

2. In lieu of consolidating districts, the Commission should address continuing problems with some districts' high rates via the following modifications to the Rate Support Fund (RSF):

    a. The RSF is currently applied as credits to usage rates which effectively increases the percentage of revenue recovered from service charge (fixed) and decreases the percentage of usage-based revenue after RSF discounts. Lowering the percentage of revenue recovered from usage-based rates has an adverse effect on conservation incentives. This is of particular concern for districts with limited water supplies where conservation is critical to maintaining safe, reliable service. To resolve this, ORA recommends replacing usage-based subsidies with subsidies applied to service charges. The Commission should modify the RSF program so that the RSF subsidy applies to service charges, not to quantity rates.

    b. To the extent practical, any customer's subsidy should not exceed the customer's monthly service charge to ensure the subsidy does not disrupt conservation price signals.[3]

    c. The resulting surcharge necessary to fund the RSF should be calculated in as conservative manner as possible to minimize its negative financial impact on those who must pay surcharges.

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[3] Under ORA's proposal, the customers of Redwood Valley District's Coast Springs and Lucerne service areas will receive subsidies that exceed their service charges. Moreover, in these districts LIRA customers' subsidies will exceed the monthly service charges by a larger amount with a further 50% reduction to the service charge.

C. DISCUSSION

1. ORA Study Methodology and Procedures

ORA reviewed CWS's prepared direct Testimony, issued data requests, reviewed CWS's data responses, and conducted field visits to each district for which CWS proposes consolidation. ORA screened CWS's RSF districts to filter eligibility of each for RSF subsidies based on each district's Median Household Income.

ORA applied a Primary Affordability Screening Threshold[4], testing whether the average customer's cost of Essential Indoor Use exceeds 2.5% of the customer's median household income. For all districts other than the Coast Springs area of the Redwood Valley district, ORA used the lower of each district's average monthly usage or 10 ccf as the monthly amount of Essential Indoor Use. For Coast Springs, ORA used 4 ccf to reflect that district's lower consumption level. With the exception of the Leona Valley service area of the Antelope Valley District, all districts currently receiving RSF funds proved to be eligible for subsidies based on this test. Leona Valley does not qualify for RSF support because its residential average monthly bill is less than 2.5% of its median household income.

ORA next applied a High Cost Threshold Filter Test to those districts who passed the initial Primary Affordability Screening Threshold Test described above to objectively test whether the districts were high cost by comparing their average residential bills to the system wide average. For this test, ORA compared each district's average total bill for Basic Water Charges on a per ccf basis (composed of Service Charges and Quantity

[4] The Commission outlined an affordability framework in R.11-11-008, D.14-10-047, Attachment A, pp. 22-23.

Based Usage Billings) to 150% of the comparable system wide average. All of the currently RSF-eligible districts passed this test.[5]

ORA then estimated subsidy requirements as the difference between the district's average quantity rate per ccf, calculated at CWS's requested quantity rate and the RSF Index of system wide cost of $4.52 per ccf. ORA then converted this amount to an equivalent per-customer surcredit using the lower of the district's average monthly residential usage or 10 ccf (four for Coast Springs) to be applied as an offset to each customers' monthly service charge to estimate CWS's Total RSF Revenue Requirement.

2. Pros and Cons of Regional District Consolidations[6]

Pros: As CWS points out in its Testimony, district consolidation offers the chance for smaller districts to spread their costs over a larger customer base, resulting in smaller rate increases and lower rates over time to the smaller district. In each case of CWS's proposed district consolidation, CWS calculates the expected rate impact on each district. Consistently, CWS projects a magnitude of rate reductions on a per-customer basis for the smaller districts that, in most cases, significantly outweigh the slightly higher per-customer rates that will result for the larger districts. (CWS Application, Attachment D, Customer Notices showing average monthly bills with and without consolidation.)

[5] ORA excluded Leona Valley from this test because it had had not passed the Primary Income Test.

[6] ORA notes the existence of several additional negative anticipated consequences of CWS's proposed district consolidations but does not further discuss them herein because the factors supporting ORA's proposals, as explained herein, provide sufficient justification for their support without discussing them. Nevertheless, two additional factors are: 1) Smaller districts experience *higher* rates in the 2nd and 3rd year of the GRC cycle under CWS's proposed consolidations; and 2) At least two of the larger districts, Bakersfield and Salinas, have significant contamination-related water supply problems of their own without having to assume the cost burden of other smaller districts' water supply problems.

Cons: District consolidations over time will shift Revenue Requirements from smaller districts to larger districts, causing higher rates for the larger districts than they would have otherwise experienced without consolidations. Cost-based rates that minimize implicit subsidies result in more economically efficient consumption, while increasing hidden subsidies results in less economically efficient consumption. Shifting costs from smaller to larger sized districts will increase *implicit* subsidies, which obscures the direct relationship of costs to rates. Moreover, ORA believes that shifts in Revenue Requirements from smaller to larger districts will, with the passage of sufficient time, cause the larger districts to justifiably question the fairness of the consolidations.[7] These revenue shifts will cause significant rate increases to the larger districts to accumulate over an extended period of time along with the economic distortions that implicit subsidies cause.

3. ORA's Proposed Guiding Principles for Subsidies

ORA supports the same general principles governing subsidies that the Commission has adopted in the telecommunications industry. The U.S. Congress incorporated these principles in drafting The Telecommunications Act of 1996.[8] The main thrust of the Telecommunications Act's treatment of subsidies is that they must be as explicit as possible and assessed on a competitively-neutral revenue base.

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[7] In ORA DR A1507015-JJS-001 (District Consolidation), ORA asked CWS: "Has CWS conducted any surveys of customers to measure whether customers' degree of acceptance, approval, etc. of the proposed consolidations? If the answer to the previous question is 'Yes,' please provide:…"
CWS responded: "No. CWS has not conducted any surveys of customers regarding consolidation."

[8] See the official FCC web site for a description of the Act at https://transition.fcc.gov/telecom.html; "Recognizing that new entrants would target those services that had above-cost rates, and thus erode universal service support, Congress included in the 1996 Act a provision requiring universal service support to be explicit, rather than hidden in above-cost rates."
https://en.wikipedia.org/wiki/Telecommunications_Act_of_1996

CWS's proposed district consolidations violate the principle of explicit, competitively-neutral subsidies and instead would increase *implicit* subsidies.[9] District consolidations will result in costs being averaged over more than one district, with a resulting shift in Revenue Requirement from the smaller to larger districts, increasing implicit subsidies, resulting in an undesirable loss of economic pricing signals.

The second principle, that subsidies should be assessed in a competitively-neutral manner, means that the expense burden of subsidies should not, without good cause, fall on customers of some services, while customers of other services are exempt. CWS's proposed consolidations would shift costs from *specific* smaller districts to *specific* larger ones, thus running counter to this principle. Charging customers of *specific* districts with the cost of other *specific* districts departs from the ideal of indifferently spreading the cost of subsidies across a large body of ratepayers in a service-neutral manner. In contrast, CWS's current RSF methodology recovers the cost of subsidies as a surcharge assessed as an equal percentage of water service revenue across all CWS districts.

An example of the principle of competitively neutral subsidy sources is the Commission's adoption of an "all end user surcharge" (AEUS), assessed on ratepayers of all telecommunications services, both landline and wireless, as a source of Universal Service Funds.[10] Accordingly, neither landline nor wireless telecommunications services

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[9] Indeed, CWS witness Townsley repeatedly describes CWS's proposal to *eliminate* explicit subsidies: "In regards to the last public interest criteria, whether any subsidies resulting from consolidation would be short, medium, or long-term, Cal Water is proposing a consolidation approach which will minimize the intra-district subsidies, and will eventually reach a status *in which no explicit subsidy is present*." (e.g., see CWS *Direct Testimony*, p. 135, *emphasis added*.) As explained above, CWS's proposal to eliminate explicit subsidies in favor of implicit subsidies is contrary to the Commission's adopted subsidy policy goals and will result in a deterioration of the goal of providing customers with economic-based pricing signals.

[10] In D.96-10-066, the Commission replaced a portion of local service subsidies that were built into the ILECs' rates with a surcharge mechanism on all customers' bills (originally set at 2.87%). Prior to D.96-

are negatively burdened with subsidy costs that would confer a relative competitive advantage to one type of service to the detriment of another. Thus, the Commission collects subsidies in a fair and equal manner. One additional benefit of spreading the subsidy costs over both types of service is that, due to a larger group of customers and revenue base, the resulting surcharges are consequently smaller in magnitude and therefore, less financially burdensome than they would be if the Commission had assessed them on a single customer group with a smaller revenue base.

4. ORA's Proposed Alternative to Update the Rate Support Fund

CWS's existing Rate Support Fund (RSF) meets the principles explained above of providing explicit subsidies assessed on a competitively neutral basis. Therefore, CWS's RSF, updated to reflect the rate increases that the Commission will grant CWS in this GRC, will better address affordability issues than CWS's proposed district consolidations. Accordingly, ORA herein recommends the following specific modifications intended to improve several of the current RSF's shortcomings:

1. Currently, the RSF is applied as credits against usage rates which effectively increases the percentage of service charge (fixed) revenue vs. usage revenue after RSF discounts. Shifting revenue recovery from usage to fixed monthly service charges adversely affects customers' conservation incentives. This is of particular concern for the Coast Springs service area of the Redwood Valley District, which is currently subject to a moratorium on new customers due to its limited water supplies. In such districts, conservation is critical to maintaining adequate water supplies. To resolve this, ORA recommends replacing usage-based

10-066 (the Universal Service Decision), ratepayers subsidized the provision of basic exchange service in certain areas of the state by paying above-cost rates for many of Pacific Bell Telephone's and Verizon's services.

subsidies, to the extent practical, with subsidies applied as reductions to service charges.

2. To the extent practical, a district's subsidy should be limited to offsetting its service charge to avoid deterioration of conservation incentives.

3. The resulting surcharge necessary to fund the RSF should be calculated in as conservative manner as possible to minimize its negative financial impact on those who must pay surcharges.

ORA has prepared and herein presents an updated estimate of the district benefits and funding requirements of the RSF. ORA's calculation reflects a scenario based upon CWS's current rates, increased by the 16.5% overall Revenue Requirement Increase CWS requests in this GRC. The calculation assumes that the subsidy will be *initially* calculated in the same manner as it currently is, as a reduction in each district's quantity charges from current rates to $4.52 per ccf, applied to a specified maximum usage level for each district. Under ORA's proposed modification, CWS will subsequently convert the quantity-rate-based subsidy calculated for each district to a per-customer reduction to the district's monthly residential service charge. Using these assumptions, ORA calculates that the RSF Program will require a surcharge of slightly less than 0.9% of "Basic Water Charges," composed of billings for quantity usage rates and monthly service charges for metered customers and the monthly charge for flat rate customers.[11]

[11] Based on CWS's reported but unverified Basic Water Charge Billing Base of $333,638,393, escalated by CWS's 16.5% requested overall Revenue Requirement Increase, and a projected annual program cost of $3,413,958. The current RSF surcharge is 0.502% applied to Basic Water Charges. ORA estimates the current program cost to be approximately $2,473,489. Accordingly, ORA's proposed update to the RSF will increase the RSF Revenue Requirement by approximately $940,469 or 38% over its current level.

ORA recommends updating this calculation to reflect the final rates that the Commission adopts in this GRC, and that CWS annually re-calculate the subsidy requirements for each district when it files a request to update the surcharge. In Chapter 4 of this Report, ORA recommends approval of CWS's request to annually recalculate the RSF surcharge in the same manner that it re-calculates the LIRA surcharge. CWS should file a Tier 2 Advice Letter to recover any RSF balance remaining as of 12/31/2016 via a one-time surcharge. CWS should request a new surcharge, re-calculated for Test Year 2017, reflecting any adopted changes to the Program that will affect RSF funding requirements. With each annual filing to update the RSF surcharge, CWS should concomitantly re-calculate the subsidy levels for each district, based on the then-current rates. In addition, effective 1/1/2017, ORA recommends approval of CWS's request to annually true-up this account via the same mechanism currently used for the LIRA Balancing Account, which the Commission approved in D.12-09-020.

D. CONCLUSION

ORA recommends denial of CWS's proposed district consolidations and adoption of ORA's proposed modifications to the RSF program.

TABLE 1-A: Preliminary RSF Subsidy Calculation

California Water Service Company Rate Support Fund Test Year 2017								
District (a)	7/21/2015 Average Residential Bill (b)	Average Monthly Usage (c)	Average $/ccf (d)	No. of Res Customers 2014 (e)	Current Subsidy/ Customer (f)	CWS' Requested District Rate Increase % (g)	Subsidy at CWS' Proposed Rates (h)	RSF Revenue Requirement With CWS' Proposed Rate Increase (i)=(e)*(h)*12
	$	Ccf	$	#	$		$	$
AV - Fremont	97.47	7	13.92	261	15.35	55.0%	40.70	127,486
Kern River Valley	115.94	6	19.32	3,967	24.48	10.0%	29.85	1,420,979
RV - Coast Springs	150.16	2	75.08	253	73.74	8.5%	83.87	254,642
RV - Lucerne	132.28	5	26.46	1,206	58.10	37.1%	92.87	1,343,961
RV - Unified	134.89	5	26.98	429	45.32	8.6%	51.84	266,890
Totals				188,738				$ 3,413,958
Estimated 2017 RSF Billing Base								$ 388,688,728
Estimated 2017 RSF Surcharge								0.878%

Note: The percentage increases shown in the above Table in the column labeled "CWS's Requested District Rate Increases" cannot be used to calculate the resulting values in the column labeled "Subsidy at CWS's Proposed Rates" because the subsidy calculation only employs quantity rates, which represent only part of the total bill increase. CWS's proposed quantity rate percentage increases vary from its overall billing increases due to differences in the percentage increases in service charges vs. quantity rates.

CHAPTER 2 : SPECIAL REQUEST #5 - IMPLEMENT MONTHLY CROSS-CONNECTION FEE

A. INTRODUCTION

CWS is proposing to fund a new manager position through monthly fees on those customers with cross-connection control assemblies, rather through rates of all customers.

B. SUMMARY OF RECOMMENDATIONS

ORA makes the following recommendations :

1. Approval of CWS's proposed new cross connection control manager.
2. Inclusion of the cost of CWS's new Cross Connection Control Manager position in CWS's total Revenue Requirements, to be recovered from all ratepayers, rather than from customers with backflow prevention devices. The backflow prevention program provides essential protection of CWS's entire water supply, thereby benefitting all customers, not only those with backflow prevention devices.

C. DISCUSSION

CWS explains that, by having one person directly responsible for the cross-connection program activities companywide, CWS can provide the districts with the required technical support, resulting in a more uniform program. CWS notes the significant growth that has occurred in the number of installed cross connection control assemblies, and the number continues to grow. ORA agrees that the program has grown sufficiently in size to necessitate creating a new manager position.[12]

[12] CWS Testimony of Paul Townsley, p. 160: "As a result of the [cross-connection control] program, 13,287 customers have been assessed and 7,349 new devices have been found or installed by customers as of the end of 2014. As shown below, this represents a 34% increase in assemblies as compared to 2011."

CWS is proposing to fund this position through a $1.50 monthly fee targeted to customers who have cross connection control devices. CWS reasons that, because the new manager position would be necessitated by the risk to the water system posed by customers with backflow potential, the customers that cause the hazards should bear the costs of the additional expenses they create. CWS further argues that the majority of CWS's customers do not currently require a backflow prevention assembly, and CWS does not believe that it would be appropriate to have all customers fund an additional manager position at this time.

ORA disagrees. The backflow prevention program is essential to protect CWS's water supply and thus, benefits all customers. ORA has included a projected cost of $125,000 for this new position in CWS projected Test Year 2017 General Office Expenses, to be recovered in CWS's total Revenue Requirements. Moreover, customers with backflow prevention devices must already incur annual costs of having their devices inspected by a licensed cross connection backflow prevention device inspector.

D. CONCLUSION

Although ORA recommends approval of CWS's proposed new position of Manager of Cross Connection Control, to be included in total Revenue Requirements for Test Year 2017, ORA recommends that the Commission deny CWS's request for a customer-specific fee to pay for the costs of the new position.

CHAPTER 3: SPECIAL REQUEST #11 - INCREASE WATER SUPPLY OR LOT FEES AND REVISE TARIFF LANGUAGE

A. INTRODUCTION

CWS is proposing to increase its Water Supply Fees[13] because they have become outdated. CWS explains that the purpose of a Facilities Fee is to charge those that are adding incremental cost or burdens to the district water system by creating need and demand for new system growth and infill needs.[14] CWS further clarifies that the Facilities Fee takes into account the proportion of the cost of providing facilities and services to previously unserved property and all changes in use that increase water demand.[15] CWS treats the collected funds as advances, which CWS accounts for as offsets to the cost of Plant in Service in Rate Base.

B. SUMMARY OF RECOMMENDATIONS

ORA recommends approval of the following CWS proposals:

1. Increased Water Supply Fees due to historical cost increases;
2. Modification of tariff language to include the terms "Lot Fees" and "Water Supply Fees" to synonymously describe these fees related to the cost recovery of the construction and installation of new facilities;
3. Elimination of the reference in CWS's tariffs to the former "Califarming Discount" because this entity no longer exists.

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[13] This Report uses the terms "Lot Fee," "New Facilities Fee," and "Water Supply Fee," synonymously, according to CWS's request.

[14] CWS Testimony of Darin Duncan, pp. 165-173.

[15] Id., at pp. 164-165.

C. DISCUSSION

CWS proposes raising the Water Supply Fees in districts with significant potential service connection growth. CWS notes that these districts are also primarily groundwater supplied districts. CWS explains that, in districts with wholesale supply, a significant investment in production capacity is not typically required to serve limited growth.

These represent significant increases from the current Fees[16]:

[16] The fees shown are per equivalent 1-inch service and is applicable to all subdivisions requiring a main extension except those extensions serving four or fewer residential lots or equivalent single-family dwelling units. The standard multiplier factors are used to determine equivalents for larger service connections. CWS proposes similar increases for Multiple Family Units. CWS Duncan's Testimony, at p. 165.

Table 3-A: Current and Proposed Facilities Fees

District	Current Facilities Fee	Proposed Fee
Bakersfield	$2,500	$5,500
Bakersfield (Califarming)*	1,050	
Chico	1,000	2,000
Dixon	1,500	2,800
King City	1,500	2,350
Marysville	450	2,200
Salinas	1,200	2,100
Selma	1,500	1,500
Visalia	1,100	4,250
Willows	1,500	2,000

*CWS proposes to eliminate this tariff element.

In attachments to its Testimony, CWS provides detailed cost estimates and rational explanations for its proposed Lot Fees in these districts.[17]

Finally, CWS explains that one developer, named Califarming, filed for bankruptcy and there is no longer a need for the reduced fee as no additional Califarming services will be added to the system. Under this circumstance, ORA agrees with CWS that it is appropriate to eliminate the reference to Califarming from its tariffs.

ORA has historically agreed with the concept of CWS's charging Lot Fees to help fund the costs of new development and, upon review, finds CWS's incremental water supply cost estimates are reasonable. The Commission should approve CWS's proposed Lot Fees.

[17] CWS Testimony of Darin Duncan, at pp. 171-172.

D. CONCLUSION

ORA recommends approval of: CWS's proposed increases to its Lot Fees as shown in the Table above; its proposed revisions to tariff language to refer to these fees as "Water Supply Fees" and "Lot Fees," and its elimination of references to "Califarming discounts" from its tariffs.

CHAPTER 4: SPECIAL REQUEST #23 – BALANCING AND MEMORANDUM ACCOUNTS

A. INTRODUCTION

This report presents ORA's review of California Water Service Company's (CWS) Balancing and Memorandum Accounts as of 6/30/2015.[18] The balances identified by ORA as of this date do not constitute ORA's recommendation for amortization or recovery by CWS since, for most accounts, recovery may be dependent on specific future actions, such as completion of projects, future calculations and reasonableness reviews.

B. SUMMARY OF RECOMMENDATIONS

a. ORA's General Recommendations Regarding Balancing and Memorandum Accounts

1. The Commission should require CWS to provide a complete set workpapers documenting the accounting adjustments that CWS makes for all of its Balancing and Memorandum Accounts. In order to accomplish this, ORA recommends that the Commission require CWS to begin keeping all documentation supporting its comprehensive reconciliation of the financial data recorded in its books of account with those it provides the Commission for ratemaking purposes. CWS should make this documentation available to ORA and the Commission staff upon request and in the workpapers supporting its next GRC Application filing. This reconciliation will provide the Commission with a complete set of accounting adjustments that CWS makes for all of its Balancing and Memorandum Accounts as of the next GRC filing date and will serve as a starting point for ORA's next review.

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[18] Including Special Request #17 – Permanent Credit Card Program.

2. ORA recommends extending for the next three years of the current GRC cycle a current provision from the Settlement in the last GRC, which conditionally permits CWS to record a regulatory asset or liability on its Balance Sheet prior to Commission approval. The required condition is that CWS has a reasonable basis to conclude that it is probable that the CPUC will authorize CWS to recover or refund these transactions via a determinable rate change. This provision allows that, if CWS determines without a relevant Commission order that an amount in a balancing or memo account should be recorded as a regulatory liability or asset on the company's Balance Sheet, rather than being included on its Income Statement, CWS agrees that it will not cite that accounting treatment as justification in favor of a particular disposition of the given amounts in an informal or formal Commission proceeding. This is not intended to prohibit CWS from referencing the regulatory treatment that has been applied to an amount.

3. CWS should make all filings relating to these memorandum accounts by Tier 3 Advice Letters or address them in its next GRC unless otherwise noted herein, allowing CPUC staff the opportunity to verify and confirm the fairness and accuracy of CWS's requested rate adjustments.

b. ORA's Recommendations Regarding Specific Balancing and Memorandum Accounts

1. American Job Creation Act True-Up Mechanism ("AJCA") – ORA recommends approval of CWS's request to close this account, with the remaining residual balances transferred to its General District Balancing Accounts after its expiration on 1/21/16.

2. Preliminary Statement F - Methyl tertiary-Butyl Ether (MTBE) Memorandum Account - ORA recommends that this account remain open until the final amount of net proceeds is known and measurable. CWS's request for a determination of the allocation split of net proceeds between CWS and ratepayers is premature and the Commission should deny it.

3. Preliminary Statement H - Low-Income Ratepayer Assistance Memo Account ("LIRA MA") - ORA recommends that the Commission authorize CWS to recover the

net LIRA administrative costs of $198,478 by filing a Tier 1 Advice Letter, at which time CWS should close the account.

4. Preliminary Statement J2 – Credit Card Memo Account ("CCMA") – the Commission should approve CWS's request to close the Credit Card Memorandum Account, and to refund the $74,307 credit balance. ORA recommends approval of CWS's credit card payment program on an on-going, permanent basis because CWS has demonstrated that it is cost effective.

5. Preliminary Statement K – Wausau Memo Account ("WMA") – ORA recommends approval of CWS's proposal to complete its reconciliation of all amounts, including accrued interest and payment of federal and state income taxes, if any, and file for disposition and closure of this account.

6. Preliminary Statement M – Water Revenue Adjustment Mechanisms and Modified Cost Balancing Accounts - ORA did not review the WRAM/MCBA balances in this GRC, since ORA already reviewed CWS's annual WRAM/MCBA Advice Letter Filings. These are ongoing Balancing Accounts and will remain open.

7. Preliminary Statement P – Department of Toxic Substances Control Memo Account ("DTSC MA") - CWS notes that, in the 2012 GRC, the parties agreed that this account could continue. CWS requests that this account remain open because of ongoing activities with California's Department of Toxic Substances Control ("DTSC.") ORA agrees.

8. Preliminary Statement Q – HomeServe Memo Account ("HomeServe MA") - ORA agrees with CWS's plans to roll the remaining residual balances over to the General District Balancing Accounts upon expiration of the surcredits for future amortization and to close this account via a Tier 1 Advice Letter Filing.

9. Preliminary Statement T – Lucerne Balancing Account ("LBA") - This Balancing Account shall remain open to track ratemaking recovery of payments on the loan for the remainder of its 30-year duration.

10. Preliminary Statement U – Tort Litigation Memo Account ("TLMA") - ORA recommends approval of CWS's request to close the account, which has a zero balance, via a Tier 1 Advice Letter Filing. CWS should provide a final reconciliation of this account via CWS's filing a Tier 3 Advice Letter or in CWS's next GRC.

11. Preliminary Statement V – PCE Litigation Memo Account ("PCE MA") - As with the Wausau Memo Account, ORA recommends approval of CWS plan to eventually reconcile all amounts and request a disposition and closure of this account. However, ORA disagrees with CWS's proposed application of litigation proceeds to only offset the capital costs of projects. Nevertheless, because the proceeds are insufficient to cover all remediation costs, this issue has no potential negative impact on ratepayers because there will not be any net proceeds left after remediation. This account should remain open, pending CWS's accounting and reconciliation of the account.

12. Preliminary Statement W – TCP Litigation Memo Account ("TCP MA") - ORA agrees with CWS's proposal to keep this account open pending the adoption of a TCP MCL, CWS's completion of the TCP litigation, remediation of damages and accounting reconciliation.

13. Preliminary Statement X – Operational Energy Efficiency Program Memorandum Account ("OEEP MA") - ORA does not recommend approval of the carrying cost of three capital projects via a Tier 2 Advice Letter, because ORA does not recommend inclusion of the costs of the associated project costs in CWS's Rate Base. ORA further recommends that this account be closed and that CWS charge its costs to below-the-line operations.

14. Preliminary Statement Z1 – Conservation Expense Balancing Account 1 ("CEBA1") - ORA recommends approval of CWS's proposal to close this account due to the expiration of the surcredits, with residual amounts transferred to CWS's General District Balancing Accounts.

15. Preliminary Statement Z2 – Conservation Expense Balancing Account 2 ("CEBA2") – ORA recommends approval of CWS's request to amortize a refund balance

(currently, of $3,975,438 as of 6/30/15), subject to final true up at the end of the 2014-2016 GRC period. The CEBA 2 should remain open through 2016, and closed after filing a Tier 3 Advice Letter to reconcile the one-way balancing account.

16. Preliminary Statement AA1 – Pension Cost Balancing Account ("PCBA1") - ORA recommends approval of CWS's request to transfer any residual amounts to the General District BAs for further amortization and to close this account upon the expiration of surcharges, effective 1/29/16.

17. Preliminary Statement AA2 – Pension Cost Balancing Account 2 ("PCBA2") – ORA recommends approval of CWS's request to amortize the remaining balance in this account after the 2014-2016 GRC period is over. ORA, however takes two exceptions to CWS's method of calculating the balance in this account. When CWS files for recovery of these expenses, it should reflect any escalation applied to this Expense as increases in Authorized Pension expenses, thus reducing the amount of any under-recovery. CWS should also use capitalization ratios that are consistent with those assumed in CWS's Test Year 2014 GRC. CWS should address these issues when CWS files to reconcile this account after 12/31/16, the expiration date of the current GRC period.

18. Preliminary Statement AB2 – Health Cost Balancing Account ("HCBA2") – CWS should only include costs in its HCBA that are not includable as valid health care costs. Although CWS included Repricing and Investigation Fees, Service and Risk Management Fees; and Administrative and Audit Fees, ORA recommends approval of them because CWS incurred them as normal costs or in an effort to realize net savings in its health care costs.

Similar to the issue noted for CWS's Pension Balancing Account, when CWS files for recovery of these expenses, it should reflect any escalation applied to this Expense as increases in Authorized Expenses, thus reducing the amount of any under-recovery. CWS should also use capitalization ratios that are consistent with those assumed in CWS's Test Year 2014 GRC. CWS should address these issues when CWS files to reconcile this account after 12/31/16.

19. Preliminary Statement AC – Pressure Reducing Valve Modernization and Energy Recovery Memo Account ("PRVMA") - Because CWS may use this account to track carrying costs associated with the construction of PRVs, this account should remain open pending CWS's completion of construction of PRV projects and its future request for ratemaking recovery of associated Revenue Requirements. ORA will address the recovery of the costs of these projects in Rate Base in a future proceeding or in a Tier 3 Advice Letter Filing after CWS's completion of the construction of and accounting for the Pressure Reducing Valve projects.

20. Preliminary Statement AD – Stockton East Litigation Memo Account ("SLMA") – ORA recommends approval of CWS's request to keep this Memorandum Account open until CWS has resolved all disputes and the amount of net proceeds is known and measurable. At that time, CWS should refund any net credit owed to CWS's Stockton District ratepayers as reimbursement of the overpayments for Purchased Water.

21. Preliminary Statement AE – 2010 Tax Law Memo Account ("2010 Tax MA") (for Bonus Depreciation) – CWS should refund the $1,840,467 that is owed to ratepayers, amortizing this amount by filing a Tier 1 Advice Letter. Upon transferring the amount owed to a Balancing Account, CWS should close this Memorandum Account.

22. Preliminary Statement AG – Catastrophic Emergency Memo Account ("CEMA") - The Commission has authorized a CEMA for all Class A water utilities and ORA recommends keeping it open.

23. Preliminary Statement AI – Chromium 6 Memo Account ("Cr6 MA") - ORA recommends the approval of any carrying costs for these projects, subject to ORA's recommendation to include the related capital costs in Rate Base. This account should remain open, reduced for grants received to fund any treatment plant costs added to Rate Base as Contributions in Aid of Construction (CIAC) and to help offset any incremental operating costs related to treatment of Cr6 contamination.

24. Preliminary Statement AJ – Low Income Ratepayer Assistance Balancing Account ("LIRA BA") – ORA recommends approval of CWS's request to annually

update and modify CWS's RSF and LIRA Programs Program Surcharges consistent with any changes made thereto in this GRC.

25. Preliminary Statement AK – 2012 Interim Rate Memorandum Account ("2012 IRMA") – ORA recommends approval of CWS's request to keep this account open for the duration of its surcharges/credits, transferring residual balances remaining upon the expiration of surcharges/credits to the General District Balancing Accounts.

26. Preliminary Statement AL – Drought Memo Account ("DRMA") - ORA recommends that CWS keep this account open for the duration of the drought. The balance of this account is $1,483,656 as of 6/30/2015. ORA will provide its recommendation for CWS's recovery of DRMA costs after CWS has completed its own internal review and reconciliation thereof. This account should remain open until the drought period has officially ended and upon CWS's de-activation of its Schedule 14.1, Rule 14.1, and Stage 3 - Critical Water Reduction of that Rule in order to meet its state-mandated water use reduction goal.

27. Preliminary Statement AM – Rate Support Fund Balancing Account ("RSF BA") – ORA agrees with CWS that the current RSF surcharge should be recalculated in this proceeding. In lieu of recommending approval of CWS's proposed district consolidations, ORA recommends updating and modifying the RSF Index and Methodology for calculating RSF subsidies. CWS should file a Tier 2 Advice Letter to recover any RSF balance remaining as of 12/31/16. In addition, effective 1/1/2017, ORA recommends approval of CWS's request to annually true-up this account with the same mechanism currently used for the LIRA Balancing Account.

28. Preliminary Statement AN – Infrastructure Act Memo Account ("Infra MA") - This account should be remain open. ORA takes no issue with this account because the amounts of gains reinvested in plant have historically exceeded the amounts of total gains on sales of property.

29. Preliminary Statement AO – Water Contamination Litigation Memo Account ("WCLMA") – The Commission has generically authorized this account for all Class A Water Utilities, and it should remain open.

30. Preliminary Statement AP – General District Balancing Accounts ("Dist BAs") - This account should remain open to accommodate the dispensation of residual balances.

31. Preliminary Statement AQ – East Los Angeles Memo Account ("ELA MA") - CWS maintains that, in the Capital Project Justification Book for the East Los Angeles District, it has provided support for its inclusion in Rate Base of projects in the ELA MA in this GRC. However, ORA does not find adequate justification for inclusion of the proposed additional costs in Rate Base. Therefore, ORA does not recommend the Commission's approval of CWS's request for ratemaking recovery of this Memorandum Account's costs.

32. Preliminary Statement AS – Asbestos Litigation Memo Account ("ALMA") - CWS reports the balance in the account to be $73,118 in litigation fees and expenses, as of June 30, 2015. ORA recommends approval of CWS's offer to verify this balance before any request for amortization and to keep this account open. CWS should file for dispensation of this account after it has completed its reconciliation via a Tier 3 Advice Letter or in CWS's next GRC.

33. Old Interim Rate Surcharge Residuals – CWS owes $1,161,591 for residual amounts to customers. CWS reports that these amounts are not part of a formally authorized memo or balancing account. ORA recommends approval of CWS's request to transfer these positive and negative residual amounts to the General District Balancing Accounts that were authorized in the 2012 GRC. All amounts owed ratepayers should be promptly refunded.

Table 4-A below provides a summary of recommendations on balancing and memorandum accounts reviewed by ORA.

Table 4-A: Balancing and Memorandum Account Summary Table (Part 1 of 2)

Preliminary Statement, Abbreviation	REGULATORY ACCOUNT	ORA's Recommendation	CWS Balance as of 6/30/2015	Per-cent of Total	ORA-Recomm. Bal. as of 6/30/2015	ORA > (<) CWS
AJCA	American Job Creation Act Mechanism	Close account upon expiration; transfer residual amounts to General District Balancing Accounts	$ (184,200)	-0.3%	$ (184,200)	0
F MTBE MA	MTBE Memo Account	Close this account upon reconciliation	$ (4,900,151) *	-6.7%	$ (4,900,151)	0
H LIRA MA	Low-Income Ratepayer Assistance Memo Account	Amortize and close	$ 198,478	0.3%	$ 198,478	0
J2 CCPP MA	Credit Card Pilot Program Memo Account (Modified)	Amortize and close this account	$ (74,307)	-0.1%	$ (74,307)	0
K WMA	Wausau Memo Account	Reconcile and Close when PCE MA is resolved	- *		-	0
M WRAM/MCBA	Water Revenue Adj. Mech. /Modified Cost Bal. Acct	Keep open; ongoing	$ 47,922,176	65.6%	$ 47,922,176	0
P DTSC MA	Dept of Toxic Substances Control Memo Account	Close this account upon reconciliation	$ 718,479 *	1.0%	$ 718,479	0
Q HomeServe MA	A.08-05-019 Memo Account (HomeServe)	Transfer residual balances to the District Balancing Accounts and close	$ 40,806	0.1%	$ 40,806	0
S WCCM	Water Cost of Capital Adjustment Mechanism	Keep Open; this is a cost of capital trigger mechanism	-		-	0
T LCBA	Lucerne Balancing Account	Keep open for the term of the loan	$ 5,780,936	7.9%	$ 5,780,936	0
U TLMA	Tort Litigation Memo Account	Close this account; Memorandum Account is not needed as CWS estimates ongoing Litigation Expense in GRC	- *		-	0
V PCE LMA	PCE Litigation Memo Account	Close this account upon reconciliation	- *		-	0
W TCP MA	TCP Litigation Memo Account	Keep open, pending adoption of a TCP MCL, completion of the TCP litigation, and remediation of damages.	- *		-	0
X OEEP MA	Oper. Energy Efficiency Program Memo Account	Amortize below-the-line and close, per ORA's recommended disallowance of associated plant.	$ 185,769 (r)	0.3%	-	$(185,769)
Z1 CEBA1	Conservation Expense One-Way Balancing Account 1	Close account upon expiration; transfer residual amounts to General District Balancing Accounts	$ (655,619)	-0.9%	$ (655,619)	0
Z2 CEBA2	Conservation Expense One-Way Balancing Account 2	Amortize and close account as of 12/31/16	$ (3,975,438) *	-5.4%	$ (3,975,438)	0
AA1 PCBA1	Pension Cost Balancing Account 1	Amortize and close account as of 1/29/16	$ 1,872,065	2.6%	$ 1,872,065	0
AA2 PCBA2	Pension Cost Balancing Account 2	Amortize as of 12/31/16; extend; conform calculations for: 1) effect of escalation on expense recovery; and 2) consistency with capitalization ratio in adopted expense forecast	$ (2,340,643) *	-3.2%	$ (2,340,643)	0
AB2 HCBA	Health Cost Balancing Account	Amortize as of 12/31/16; extend; conform calculations for: 1) effect of escalation on expense recovery; and 2) consistency with capitalization ratio in adopted expense forecast	$ 2,468,803 *	3.4%	$ 2,468,803	0

Table 4-A: Balancing and Memorandum Account Summary Table (Part 2 of 2)

Preliminary Statement, Abbreviation	**REGULATORY ACCOUNT**	**ORA's Recommendation**	**CWS Balance as of 6/30/2015**	**Per-cent of Total**	**ORA-Recomm. Bal. as of 6/30/2015**	**ORA > (<) CWS**
AC PRV MA	Pressure Reducing Valve Memo Account	CWS to provide an accounting of its PRV Projects; keep account open, pending project completion	- *		-	0
AD SLMA	Stockton East Litigation Memo Account	Close this account pending completion of litigation and CWS's reconciliation	$ (400,272) *	-0.5%	$ (400,272)	0
AE Bonus Tax MA	Bonus Tax Depreciation Memo Account	Approve refund via CWS' filing a Tier 1 Advice Letter; balance shown is as of 12/31/2013	$ (1,840,467)	-2.5%	$ (1,840,467)	0
AG CEMA	Catastrophic Event Memo Account	Keep open as authorized by PUC Section 454.9	-		-	0
AI CR6 MA	Chromium-6 Memo Account	Keep this account open until research is done and CWS reconciles and accounts for all grants; ongoing.	$ 18,223 *	0.0%	$ 18,223	0
AJ LIRA BA	LIRA Balancing Account	Approve by rolling balance into 2016 LIRA surcharge; ongoing,	$ 2,449,181 *	3.4%	$ 2,449,181	0
AK 2012 IRMA	2012 GRC Interim Rate Memo Account	Keep open; upon surcharge expiration transfer residual balances to the District Balancing Accounts and close.	$ 20,273,335 *	27.8%	$ 20,273,335	0
AL DRMA	Drought Memo Account	Review after CWS's completion of internal review and reconciliation; keep open until drought ends.	$ 1,483,656 *	2.0%	$ 1,483,656	0
AM RSF BA	Rate Support Fund Balancing Account	Effective. 1/1/2017, annually re-calculate 2017 RSF surcharge and subsidies for RSF Program changes.	$ 424,236 *	0.6%	$ 424,236	0
AN Infra MA	Infrastructure Act Memo Account	Keep account open	-		-	0
AO Water Contam MA	Water Contamination Lit. Memo Account	Keep this generically authorized account open	-		-	0
AP Gen BA	General District Balancing Accounts	Keep account open; ongoing	$ 524,271	0.7%	$ 524,271	0
AQ ELAMA	East Los Angeles Memo Account	Keep account open; ORA does not recommend approval of ELA Memo Account Projects at this	$ 1,624,535 (r) (1)	2.2%	$ 1,624,535	0
AR SRM	Sales Reconciliation Mechanism Bal Account	Close this account	-		-	0
AS ALMA	Asbestos Memo Account	Amortize, subject to Review of CWS's reconciliation; keep open, ongoing	$ 73,118 *	0.1%	$ 73,118	0
IFRS MA	International Financial Reporting Standards MA	Keep open, awaiting SEC trigger	-		-	0
Various	Old Interim Rate Surcharge Residuals	Amortize, keep open until expiration	$ 1,161,591	1.6%	$ 1,161,591	0
		TOTAL:	**$ 73,032,761**	**100.0%**	**$ 72,846,992**	**$(185,769)**

Notes: (*) Subject to ORA's Review.
(1) CWS Estimated as of 12/31/16.
(r) Subject to ORA's recommendation on related Rate Base.

C. INTRODUCTION AND BACKGROUND ON MEMORANDUM ACCOUNTS

This chapter presents ORA's analyses and recommendations on CWS's balancing and memorandum accounts.

1. Background on Memorandum and Balancing Accounts

Memorandum accounts are intended to be "off book", i.e. tracking items that CWS should not record in its books of account and their purpose is to allow CWS to record costs that it is not recovering through its currently authorized rates or revenue requirement. Memorandum accounts are not used to track ongoing normal business expenses, such as maintenance and other categories of operating expenses. Excluding such normal operating costs from CWS's memorandum accounts is of primary focus and concern in ORA's review in order to avoid double recovery of expenses. Memorandum accounts are used to track costs whose recoveries are not assured, in whole or in part because CWS cannot estimate them in advance. Memorandum Accounts are subject to reasonableness reviews prior to the Commission's authorization of ratemaking recovery. In some cases, the nature of the issue whose costs are to be tracked has not yet been fully explored, known, or understood and its regulatory treatment is, therefore, uncertain. Yet, it is necessary to provide for potential future rate recovery in a manner that avoids retroactive ratemaking. Therefore, when the Commission cannot adopt a reasonable estimate of costs related to specific events, a memorandum account leaves the issue open for eventual resolution by providing an opportunity to track associated costs for possible future rate recovery. If CWS seeks a memorandum account on its own initiative, however, it must justify that the account is necessary "due to events of an exceptional nature" that:

(1) Are not under CWS's control,
(2) Could not have been reasonably foreseen in the last general rate case,
(3) Will occur before the next scheduled rate case,
(4) Are of a substantial nature in that the amount of money involved is worth the effort of processing a memo account, and
(5) Have ratepayer benefits.[19]

Similarly, Balancing Accounts track the incurrence of expenditures against the surcharge/surcredit recovery of expenditures, which are generally considered pre-approved and authorized for recovery against their associated surcharges. Nevertheless, both types of accounts are subject to periodic regulatory review[20] and, if found necessary, the Commission may make subsequent adjustments to the balances it authorizes for recovery without violating the ban on retroactive ratemaking.

Both Balancing and Memorandum Accounts are used to record costs for tracking purposes and to allow a utility an opportunity to meet its burden of proof for the recovery of the recorded costs. Recovery of the accumulated costs is not automatic, and recovery of costs for both types of accounts must be found just and reasonable by the Commission.

2. CWS Compliance with the 2012 GRC Settlement with ORA

In CWS's prior GRC, ORA noted in its report that CWS did not have formal procedures in place for consistently recording transactions in and maintaining its numerous existing memo and balancing accounts.

In CWS's and ORA's Settlement, the Parties agreed that CWS should establish more formal internal procedures to ensure that the company's memo and balancing accounts are

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[19] Commission Standard Practice (SP) U-27 at 6.

[20] The Division of Water and Audits refers to Balancing Accounts as "Memorandum accounts with Balancing Account characteristics," emphasizing that these accounts are equally subject to reasonableness reviews. See Decision 03-06-072.

more consistently maintained.[21] During the settlement process the parties discussed how the process should be improved. CWS agreed to apply the formal processes established for new memo and balancing accounts to existing memo and balancing accounts. As part of the improvement process, CWS's stated goal is to maintain a current running balance in each of the accounts going forward (except in situations where the amounts to be included in the account may not be identified until a later date, e.g., tax accounts, certain legal accounts that may not be billed until the end of the case, etc.) The Settlement specified formal procedures that CWS agreed to develop for its memo and balancing accounts.[22]

The Settlement Agreement further specified specific milestones for CWS's developing a more formal internal review process, and procedures/guidelines for memorandum and balancing accounts are as follows:

• November 27, 2013: Complete spreadsheet with details of all memorandum and balancing accounts.

• January 6, 2014: Complete modifications to written internal procedures/guidelines for maintaining memorandum and balancing accounts. These spreadsheets and written internal procedures/guidelines are required to include:

1) A detailed description of the step-by-step process of recording transactions in the memorandum and balancing accounts;

2) Detailed instructions for the process of determining which transactions are eligible to be included (e.g., effective date that transactions can begin being recorded in the accounts, types of costs, etc.);

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[21] The Settlement Agreement approved in D.14-08-011, Chapter 7, section A.1., pp. 35-36.

[22] *Id.*

3) A detailed discussion of how certain departments will coordinate with respect to memorandum and balancing accounts that require different types of costs to be captured (e.g., engineering (plant expenditures), legal costs, etc.);

4) A finalized approach for storing and organizing legal invoices and detailed instructions as to how the legal invoices will be recorded and/or allocated to the litigation memorandum accounts;

5) A detailed discussion of how to ensure that expenses that are already included in rates, are not also double-counted in the memorandum and balancing accounts (e.g., internal labor, overhead costs, legal expense, etc.);

6) Instructions for maintaining the older balancing and memorandum accounts;

7) Identification of any special reporting CWS is required to make in association with each memorandum and balancing account (e.g., litigation status reports, conservation reports, etc.);

8) All preliminary statements should be attached to the guidelines for ease of reference; and,

9) A process for systematically updating the guidelines and spreadsheets every GRC cycle and periodically to account for any new changes in the existing accounts as well as addition/deletion of accounts.[23]

In Response to ORA's Data Request for these new procedures[24], CWS provided its accounting procedures for these accounts. ORA has reviewed these procedures and, with one significant exception, believes that CWS has significantly complied with the Settlement's requirements. The exception relates to CWS's timing of recording transactions to its Memorandum Accounts.

CWS describes its practice of booking Balancing and Memorandum Accounts as follows:

[23] Id.

[24] Data Request No. ORA DR A1507015-JJS-018 (CWS Final Procedures for Balancing and Memorandum Accounts.)

> Cal Water books the revenue and allowable cost components tracked in a balancing account on the Balance Sheet and Income Statement when it is probable that the CPUC will authorize Cal Water to recover or refund a determinable amount via a rate change. If it is not probable that the CPUC will authorize Cal Water to recover or refund a determinable amount via a rate change, the transactions in a balancing account are tracked as Off-Balance Sheet transactions.
>
> Amounts in memorandum accounts are booked on the Balance Sheet and Income Statement when it is probable the CPUC will authorize Cal Water to recover or refund these transactions via a determinable rate change. If it is not probable that the CPUC will authorize Cal Water to recover or refund a determinable amount via a rate change, the transactions in a memo account are tracked as Off-Balance Sheet transactions.[25]

Several of CWS's Preliminary Statements require entry and recording of all costs in Memorandum Accounts on a monthly basis.[26] As ORA noted in its last Audit Report on CWS's Balancing and Memorandum Accounts[27], notwithstanding these Commission-authorized requirements, CWS has in most instances, been postponing recording any costs in the Memorandum Accounts until a "triggering event" has occurred. These events include CWS's: 1) Completion of projects; 2) Filing a request for amortization and recovery of account balances; and/or 3) Booking of a regulatory asset or liability on its Balance Sheet. Thus, many of CWS's memorandum accounts reported herein show zero balances. Notwithstanding the Settlement in the last GRC, CWS continues this practice.

CWS attempts to justify this accounting practice as follows:

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[25] Attachment 1 to CWS's Response to ORA DR A1507015-JJS-018 (CWS BAMA Internal Controls and Procedures), Balance and Memo Accounts Policy I.A.4 - 12-31-15

[26] See, for example, CWS's Preliminary Statements for its Pressure Reducing Valve Modernization and Energy Recovery Memo Account ("PRVMA") and for its MTBE Memo Account, which both specifically require monthly recording of transactions to the Memorandum Accounts.

[27] *Division Of Ratepayer Advocates Report On The Balances In The Memorandum And Balancing Accounts Of California Water Service Company, General Rate Case Application 12-07-007, Test Year 2014 Escalation Years 2015 and 2016*, dated March 1, 2013.

> One complicating factor may be that some utilities may have a separate set of books for ratemaking and a separate set for financial accounting. Cal Water, however, maintains financial accounting records consistent with its regulatory records. To the extent that costs are incurred or revenues are received, financial accounting requires that they be put on the "operating statement" and expensed (from an accounting perspective), or treated as a regulatory asset or liability and put on the "balance sheet." When Cal Water looks at the books for ratemaking purposes, however, Cal Water begins with the operating statements, and adjusts them as appropriate to develop a forecast. Through this ratemaking analysis, which only occurs when a GRC is filed (or some other triggering event occurs), certain expenses and revenues may be removed from the forecast. One category of amounts adjusted out should be those that the Commission has determined must specifically be evaluated before recovery is allowed such as those in memo accounts.
>
> Because a separate set of ratemaking books is not maintained, there is no ratemaking impact if memo account amounts are not identified as such on a monthly basis, as many preliminary statements currently require. In some cases, there is a financial accounting need for this monthly reconciliation when an amount is being booked on the balance sheet. Otherwise, there is no ratemaking impact of amounts tracked in a memo account unless and until Cal Water either files a general rate case, or requests recovery for the account.
>
> Cal Water agrees generally that amounts that should be included in memo accounts should be "off-book" from a ratemaking perspective, which is accomplished by not including the amounts in rates. With regard to whether an amount is considered to be a regulatory liability or regulatory asset is a determination governed by GAAP and financial reporting standards. Therefore, the Commission should not find any violation of its policies with regard to Cal Water's practice of booking some accounts to its balance sheet.[28]

ORA understands CWS's argument that it must maintain its books of account according to financial accounting requirements. Nevertheless, ORA takes exception to CWS's accounting practice to defer recording transactions in its memorandum accounts because

[28] CWS Response to JJS-016 – PRVMA, p. 4, quoting CWS's 2012 GRC, Rebuttal on General Issues (Book 1), pp. 60-62. CWS's policy statements in this Data Response are representative of CWS's general policy regarding all of its Memorandum Accounts.

it constitutes a failure to follow Commission accounting requirements to keep its memorandum accounts current in accordance with the pre-defined requirements of CWS's Preliminary Statements. CWS must adhere to these requirements because they represent the terms under which the Commission has agreed to authorize the memorandum accounts. CWS's practice of deferring its accounting of Memorandum Accounts is also objectionable because it creates undisclosed and unexplained differences between CWS's financial data recorded in its books of account and those that it provides the Commission for ratemaking purposes.

In order to resolve this problem, the Commission should require CWS to provide a complete set workpapers documenting its comprehensive reconciliation of the financial data recorded in its books of account with those it provides the Commission for ratemaking purposes. ORA recommends that the Commission also require CWS to begin keeping all documentation needed to support its comprehensive reconciliation of the financial data recorded in its books of account with those it provides the Commission for ratemaking purposes. CWS should make this documentation available to the ORA and Commission staff upon request and should also include it in the workpapers supporting its next GRC Application filing. This reconciliation will serve as a useful starting point for ORA's next Balancing and Memorandum Account review.

The Commission should place CWS on notice of this requirement to allow CWS to immediately begin to collect, preserve, and store all records necessary for assembling and presenting the requested reconciliation upon request and with its next GRC Application.

D. ANALYSIS AND RECOMMENDATIONS BY ACCOUNT - MEMORANDUM AND BALANCING ACCOUNTS IN CWS's APPLICATION[29]

1. American Job Creation Act True-Up Mechanism ("AJCA")

The AJCA has a balance of ($184,200) as of 6/30/15. CWS requests closure of this account, after the expiration of surcredits on 1/21/16, with remaining residual balances transferred to its General District Balancing Accounts. CWS has already largely refunded the refunds due and ORA agrees with CWS's proposed closure of this account.

2. Preliminary Statement F – Special Request: Methyl Tertiary-Butyl Ether Memorandum Account (MTBEMA)

CWS reports an MTBEMA balance of ($4,900,151) as of June 30, 2015. CWS requests to amortize the estimated net proceeds that CWS expects to remain in this account, and close it, returning 75% of the net proceeds to shareholders and 25% to ratepayers.[30] Two points of contention with CWS are: 1) In addition to capital remediation costs, the Litigation Proceeds should be used to pay for the operating expenses of MTBE treatment plant; and 2) CWS should apply all available Litigation Proceeds to offset the full remediation costs of subsequent detections of MTBE.

[29] Unless noted otherwise, the source of these account descriptions are CWS's General Report, beginning at p. 20 and represent CWS's statements. As noted below, due to the uncertainty surrounding the ultimate disposition of most of these accounts, and pending CWS's reconciliation and finalization thereof, many of these accounts are subject to further review.

[30] Tootle Testimony at p. 223. Mr. Tootle's Testimony provides additional historical details on CWS's MTBE Litigation and the MTBE MA, a discussion of the remaining proceeds, and CWS's proposal for distributing those proceeds between shareholders and ratepayers.

Regarding the first point, the MTBE Memorandum Account's Preliminary Statement states that the MTBEMA will track both investment in replacement property and Operational and Maintenance (O&M) expenses of the replacement property:

> "1. PURPOSE: The purpose of the MTBEMA is to track the costs incurred and proceeds received and applied with respect to litigation against manufacturers, refineries, and service station operators referred to as potentially responsible parties (PRPs), that produced and/or distributed products, which contained methyl tertiary butyl ether (MTBE). Cal Water will incur external costs to support its litigation effort. The MTBEMA will track actual costs. The MTBEMA will also track litigation awards and settlement proceeds. *Finally, the MTBEMA will track application of funds received toward investments in replacement and treatment property and expenses (internal and external) to operate, manage, and maintain that property.* The Commission will determine the disposition of the MTBEMA in connection with Cal Water's general rate cases or a separate proceeding." (*Emphasis added*.)

CWS's Testimony only describes MTBE capital investment and does not specifically describe an expense component. Accordingly, ORA asked whether CWS should use MTBE litigation proceeds to offset the additional expense of treating MTBE-contaminated water, in addition to the remediation component that CWS says that it will record as offsets to Rate Base as Contributions in Aid of Construction (CIAC).[31]

CWS responded: "On page 228 of Cal Water's Testimony Book, Mr. Tootle explains the beneficial tax treatment Cal Water was able to obtain by ensuring that litigation proceeds are only used for 'replacement property,' as defined by the federal Tax Code, which does not include costs for expenses… Cal Water has not recorded water treatment expenses in

[31] ORA DR A1507015-JJS-012 (MTBE Contamination Costs.)

this Memo Account, and for the reasons described above, is not proposing that litigation proceeds be used to offset water treatment expenses."[32]

CWS further explained two factors affecting its position: 1) That CWS has expended most of the capital costs of MTBE remediation for replacement wells, and that CWS had abandoned MTBE-contaminated wells in favor of employing new or other sources of water supply; and 2) In the few instances in which CWS is treating for MTBE-contaminated water, it is jointly treating for other contaminants, and it is not possible to apportion the part of expenses related exclusively to MTBE.

ORA researched several background decisions for further guidance on this issue:

1. Decision (D.) 10-04-037 (A.09-07-011 (Application of California Water Service Company for an Order authorizing the allocation of Net Proceeds from MTBE (methyl tertiary-butyl ether) Groundwater Contamination Litigation) - the decision adopting a Settlement Agreement between ORA and CWS (CWS) resolving Phase 1 issues;

2. D.11-03-043, the decision in the same case as (1), deferring remaining Phase 2 issues to a future GRC. Appendix A thereto, is a Memorandum of Understanding (MOU) between ORA and CWS, which recites the terms upon which both Parties had reached agreement on the Phase 1 issues in that proceeding;

3. D.10-10-018 (Modified by D.10-12-058) (R.09-03-014, Rulemaking to Develop Rules and Procedures to Ensure that Investor-Owned Water Utilities Will not Recover Unreasonable Return on Investments Financed by Contamination Proceeds, Including Damage Awards, and Public Loans Received Due to Water Supply Contamination, hereinafter referred to as the "Contamination Rulemaking Proceeding") – Decision Adopting Rules for Accounting Treatment of Contamination Proceeds

[32] CWS's Response to ORA DR A1507015-JJS-012 (MTBE Contamination Costs), Q. 1, p. 2.

Arising From Government Grants and Proposing Counterpart Rules For Government Loans and Damage Awards.

According to these decisions, the MTBE contamination remediation and replacement costs include both capital investment costs and expenses incurred for treatment of the water supply in order to comply with GO 103-A standards. Confirming this, the definition of "net proceeds" that the Commission adopted in D.10-10-018 (Contamination Rulemaking Proceeding) is:

> Gross proceeds received minus all (1) reasonable legal expenses related to litigation, (2) costs of remedying plants, facilities, and resources to bring the water supply to a safe and reliable condition in accordance with General Order 103-A standards, and (3) all other reasonable costs and expenses that are the direct result and would not have to be incurred in the absence of such contamination, including all relevant costs already recovered from ratepayers (for which they have been, or will be, repaid or credited).[33]

In summary, the definition of "net proceeds" that the Commission adopted in D.10-10-018, the industry-wide Contamination Rulemaking Proceeding, is consistent with the definition of the same adopted in CWS's s separate proceeding which culminated in D.10-04,037, was confirmed in D.11-03-043 (Appendix A), and was left unmodified by D.10-12-058 (which modified some of the previously adopted rules.) Furthermore, in D.11-03-043, Appendix A, CWS's and ORA's Memorandum of Understanding, Item #2 affirmatively notes that CWS and ORA agreed to amend the Memorandum Account as approved by D.10-04-037 to state that the MTBEMA shall be used to record for future disposition of all proceeds, capital investments, and operating expenses associated with MTBE contamination."[34] These definitions unanimously support ORA's position that

[33] D.10-10-018, p. 46, Conclusion of Law (COL) 11, and Ordering Paragraph (OP) 6.

[34] *Id.* at pp. 1-2.

CWS must track all remediation costs, including MTBE treatment-related operational expenses in the MTBEMA. Because these costs would not have been incurred in the absence of MTBE contamination, CWS must therefore include them in the MTBEMA.

The Audit Report of the MTBE Memorandum Account attached as Appendix B to D.10-04-037 raised this very same issue that ORA is now raising in the current case. In that Report, issue (II) states:

> *Whether MTBE related Administrative and General ("A&G") and Operation and Maintenance ("O&M") expenses have been correctly accounted for in the MTBEMA. (Emphasis in Original)*

The Report notes the requirement for CWS to include these costs, explaining:

> According to one of the MTBEMA requirements [Footnote omitted.], Cal-Water is to record, at the end of each month, all incurred O&M and A&G expenses associated with MTBE litigation activities in the MRBEMA. However, thus far no entries pertaining to such expenses have been recorded besides three entries noted in Table 1." (Footnote 7: The three accounting entries are related to the external professional services retention regarding Cal-Water's request for a private letter ruling from the Internal Revenue Service ("IRS"). The purpose of the request is to have the MTBE litigation proceeds be exempted from taxation based on an asset "involuntary conversion" provisions afforded under the Internal Revenue Code (IRC), Section 1033. [End footnote 7.][35]

Based upon this review of the Commission's background decisions, CWS's assertion regarding the application of litigation proceeds to capital costs, to the exclusion of O&M expenses lacks merit based on the definition of "net proceeds" because the remediation costs extend beyond capital investments. In order to bring the water supply to a safe and reliable condition in accordance with General Order 103-A standards, CWS has and will continue to incur MTBE treatment-related expenses, which are necessary to restore

[35] D.10-04-037, Appendix B, pp. 3-4.

CWS's MTBE-contaminated water to safe conditions. Such expenses associated with MTBE contamination must be tracked in the MTBE Memorandum Account and used in the calculation of net proceeds before discussing CWS's proposed allocation of those proceeds between shareholders and ratepayers.

D.10-12-058 foresaw and forewarned about the risks of a premature allocation of net proceeds between shareholders and ratepayers:

> Any sharing before the completion of remediation or replacement would run the risk of future shortfalls that the IOU would seek to cover through rates. To allow allocations to be made before remediation and replacement is complete would shift the risk of incomplete, unfunded or unnecessarily deferred remediation and replacement to the ratepayer. Further, the potential for associated impacts on service if such contingencies were to occur would not be in the public interest generally.
>
> With this adopted "net proceeds" definition as a starting point for considering sharing, it is possible that no proceeds will be left after deductions are made; in short, in any given instance there might be nothing—no excess—to allocate. As a corollary, of course, the objectives of remediation and replacement may have been well served by not allowing a premature allocation to ratepayers and/or shareholders. …[36]

ORA recommends that the Commission heed this warning. Based on ORA's review of the historical background of CWS's MTBE contamination issue, ORA concludes that CWS's accounting practices do not comply with the Commission's established policies as reflected in CWS MTBEMA's Preliminary Statement and may jeopardize CWS's proper application of litigation proceeds to offset the full costs remediation.

A secondary, but of greater importance, issue is that ORA notes that CWS fails to follow the Commission's rules relating to subsequent discoveries of MTBE contamination.

[36] *Id.* at p. 47.

CWS informed ORA that additional remediation can, and has been discovered which can require use of the MTBE litigation proceeds to pay for remediation costs. In its Data Response, CWS alleges that it cannot use litigation proceeds for additionally detected MTBE contamination.[37] Nevertheless, CWS is recording in the MTBE MA its receipt of litigation proceeds related to subsequent MTBE detections, but only records an amount of the related remediation costs that is equal to amount of the proceeds. CWS is proposing to add the remainder of the remediation costs to Rate Base without any offsetting credit to Contributions in Aid of Construction (CIAC) as required by CWS's MTBE Preliminary Statement and by the Commission decisions cited above. Specifically, CWS has requested approval of two capital addition projects that are currently under construction, one of which resulted from a subsequent MTBE detection. CWS requests to add the net costs of the latter project (after application of Litigation Proceeds only resulting from subsequent-detection payments to CIAC) to Test Year 2017 Rate Base. The net cost of this project, after applying the additional litigation proceeds CWS received for subsequent detections, is $2,757,582.[38]

[37] CWS's Response to ORA DR A1507015-JJS-012 (MTBE Contamination Costs), Q. 1, p. 3, states: "The last project, 61633, is still open and is estimated to close at $2,575,582 (see RO Salinas Report, page 31). It is a new MCLE detection that was not included in the main litigation, however, so the full amount of the project will not qualify for the litigation proceeds under the settlement. Instead, as a new MCLE detection under the settlement, Cal Water has received a check for partial offsetting proceeds in the amount of $332,384."

CWS shows this same amount as first credited to the MTBE Memorandum Account, then later reversed, with the description: "PCE settlement booked to MTBE in error; funds applied to PID 61633 in Salinas." CWS's transaction list for the PCE Memorandum Account shows this same amount as being deducted from the PCE litigation proceeds with the cryptic explanation: "Minus Multimatic Federal Action settlement." Accordingly, based upon these conflicting data, it appears that CWS has not yet finalized its accounting entries for either of these Memorandum Accounts and the Commission should not rely on their results at this time.

[38] Cost of Replacement well in Salinas (PID 61663) - gross amount is $3,089,966, less MTBE proceeds of $(332,384) = $2,757,582. (CWS's 2/17/16 e-mail message from Teresita Cayas to James Simmons (ORA).)

CWS does not believe it is obligated to apply any of the net Litigation Proceeds remaining from its first Settlement to offset the remediation costs of these subsequent detections, and is unwilling to do so.[39] However, CWS's interpretation is inconsistent with the stated purpose of the MTBE Memorandum Account: to record *all* MTBE litigation proceeds along with *all* costs CWS incurs for treatment of MTBE-contaminated water. The Preliminary Statement, as affirmed by CWS's and ORA's MOU (D.11-03-043, Appendix A) makes no distinction between timing of the receipt of litigation proceeds and/or the incurrence of remediation costs. CWS is required to record in its MTBE MA all costs and proceeds relating to MTBE contamination after the 2008 date of the original MTBE Litigation Settlement. CWS has provided no reasonable basis for failing to apply litigation proceeds to offset the full remediation costs as the Commission's past decisions require. CWS must use the MTBE litigation funds to pay for all identifiable remediation costs prior to requesting the Commission's approval to split and return funds to shareholders and ratepayers.

For these reasons, CWS has not and cannot quantify the final, actual amount of net litigation proceeds at this time, and, consequently, the Commission cannot make an informed decision regarding the fair and equitable split of net proceeds without first knowing the amount of net proceeds that actually remain after taking into account all remediation costs. CWS's request to allocate 75% of net proceeds to its shareholders and 25% to ratepayers is therefore, premature and should be deferred without prejudice. Accordingly, ORA recommends that CWS retain all remaining proceeds and use them exclusively for the purpose of remediation, rather than refunding them to shareholders

[39] CWS's Response to ORA DR A1507015-JJS-012 (MTBE Contamination Costs), Q. 1, p. 2, cited above.

and ratepayers, until the final amount of net proceeds is known and measurable.[40] This account should remain open, pending CWS's final quantification of net proceeds in a future proceeding. The final quantification of net proceeds must account for *all* net litigation proceeds and costs CWS incurs for treatment of MTBE-contaminated water as the Commission requires.

3. Preliminary Statement H – Special Request: Low-Income Ratepayer Assistance Memo Account ("LIRA MA")

The LIRA MA shows a balance of $198,478 as of 6/30/15, and tracks the administrative costs of the LIRA Program.[41] CWS reports that it will need to continue tracking all LIRA costs for the purpose of annual reporting to the Commission. CWS requests to keep this account open.

The balance in this account is in line with the amount of LIRA administrative expenses that the Commission authorized for recovery in the last GRC. Accordingly, ORA recommends that the Commission authorize CWS to recover CWS's requested net amount by filing a Tier 1 Advice Letter; however, the Commission should direct CWS to close the account because CWS has been able to prospectively estimate the LIRA administrative costs for this GRC and accordingly, CWS cannot justify the need to continue this Memorandum Account.

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[40] ORA notes that a duplicate invoice was found in the review of the last GRC (A.12-07-007.) In its most recent reconciliation, CWS shows that it has adjusted the balance to remove this duplicate invoice.

[41] Spreadsheet *Analysis of LIRA MA Costs (10-31-15) (names deleted).xls*, Attachment to Natalie Wales e-mail dated 11/1/15. Amounts listed in the spreadsheet include tracked LIRA Program administrative costs through 8/5/15. CWS also reports this amount as the balance as of 6/30/15. If CWS incurs additional LIRA administrative costs, it should wait for the next GRC to request their recovery because CWS has not requested them in this GRC and they are, therefore, not includable in the amount ORA recommends for approval and recovery in this GRC.

Regarding CWS's practice of recording the Balance of this account on its Balance Sheet, ORA and CWS reached agreement to following provision in the last GRC's Settlement:

> To the extent Cal Water determines without a relevant Commission order that an amount in a balancing or memo account should be recorded as a regulatory liability or asset on the company's 'balance sheet,' rather than being included on its income statement, Cal Water agrees that it will not cite that accounting treatment as justification in favor of a particular disposition of the given amounts in an informal or formal Commission proceeding. This is not intended to prohibit Cal Water from referencing the regulatory treatment that has been applied to an amount.

ORA recommends extending this provision for the next three years of the current GRC cycle.

4. Preliminary Statement J2 – Credit Card Memo Account ("CCMA") – Special Request # 17 - Permanent Credit Card Program

As of 6/30/15, the CCMA has a ($74,307) (net refund due) balance. Currently, CWS requests no recovery for this account, adding that this account should be eliminated because CWS believes its credit/debit card program is cost-effective, with no additional fee paid by credit/debit users, and no cross-subsidy from customers who pay by other means. The Commission should approve CWS's Credit Card Payment Program on a permanent basis, and should require CWS to refund the balance due from this Memorandum Account. CWS should close this Memorandum Account upon transfer of the balance to the General District Surcharge Balancing Accounts.

5. Preliminary Statement K – Wausau Memo Account ("WMA")

The WMA account shows a zero balance as of 6/30/2015. With net settlement proceeds received from outside counsel, CWS reports that it has now fulfilled its settlement obligation and commitment with Wausau. CWS states that it intends to complete its reconciliation of all amounts, including accrued interest and payment of federal and state income taxes, if any, and file for disposition and closure of this account, in coordination with CWS's reconciliation of the PCEMA. CWS requests no recovery for this account because it expects it to have a zero balance. ORA agrees that this account should be closed should when the PCEMA is resolved and upon CWS's providing a final reconciliation through filing a Tier 3 Advice Letter or in CWS's next GRC.

6. Preliminary Statement M – Water Revenue Adjustment Mechanisms and Modified Cost Balancing Accounts

CWS reports that, as of June 30, 2015, the balance in the WRAM/MCBA account was $47,922,176 (representing a net WRAM revenue under-recovery.) ORA did not review the WRAM/MCBA balances in the GRC. CWS annually files annual information-only filings and amortization advice letters. These accounts should remain open as ongoing Balancing Accounts.

7. Preliminary Statement P – Department of Toxic Substances Control Memo Account ("DTSC MA")

CWS reports that, as of June 30, 2015, the balance in the DTSC MA was $718,479[42] in expenses. CWS notes that, in the 2012 GRC, the parties agreed that this account could continue because of ongoing activities with California's Department of Toxic Substances Control ("DTSC"). CWS has agreed to undertake certain activities requested by the DTSC such as groundwater testing and analysis regarding the plume in the Visalia water basin contaminated with perchloroethylene, also known as tetrachloroethylene (PCE). CWS requests that this account remain open, subject to CWS's final reconciliation. ORA recommends that CWS provide its reconciliation and close this account via filing of a Tier 3 Advice Letter or in its next GRC.

[42] ORA has not verified the accuracy of this amount, and it is subject to CWS's final verification.

8. Preliminary Statement Q – HomeServe Memo Account ("HomeServe MA")

The HomeServe MA shows a balance $40,806 as of 6/30/2015. CWS plans to roll the remaining balances, which represent amounts that CWS still needs to refund to ratepayers, to the General District Balancing Accounts for future amortization and requests to close this Memorandum Account at that time. ORA agrees that CWS should close this account via a Tier 1 advice letter upon expiration of the surcredits.[43] Consistent with the Commission's previous approval, no further issues remain and CWS will dispense with the residual amounts through CWS's General District Surcharge/credit Balancing Accounts.

9. Preliminary Statement T – Lucerne Balancing Account ("LBA")

As of June 20, 2015, the LBA had a balance of $5,780,936. This balancing account tracks the difference between the $7,078,698 low-interest 30-year loan for customers in the Redwood Valley (RWV) - Lucerne District authorized in D.08-09-002, and the surcharges on those customers collected to pay back the loan. This Balancing Account should remain open for the duration of the loan.

10. Preliminary Statement U – Special Request: Tort Litigation Memo Account ("TLMA")

The TLMA shows a zero balance as of 6/30/2015. CWS explains that the Tort Litigation Memo Account was created to track the costs and any settlements related to a civil case brought against CWS alleging water contamination that led to the death of an individual. CWS incurred legal costs in the litigation, paid a settlement to resolve the case, and obtained reimbursement from its insurance company to offset certain costs. All of the

[43] CWS notes that an amount of $22,576 must still be returned to customers in 17 districts, and $2,264 must be recovered from customers in five districts.

amounts for litigation costs, settlement, and insurance reimbursement have been included in the account for legal expenses (798100) that form the basis for the expense forecasts in the 2012 GRC as well as in this GRC. Accordingly, CWS considers the TLMA to have a balance of zero, and requests to close the account via a Tier 1 advice letter. ORA agrees with CWS's proposal, but recommends CWS provide a final reconciliation of this account via CWS filing a Tier 3 Advice Letter or in CWS's next GRC. CWS should close this Memorandum Account after reconciliation and transferring out any remaining balances.

11. Preliminary Statement V – PCE Litigation Memo Account ("PCE MA")

The PCE MA shows a zero balance as of 6/30/2015. CWS reports that, in the second quarter of 2015, CWS reached settlements with all defendants alleged to be potentially responsible parties for PCE contamination. The settlements total approximately $2.3 million; however CWS incurred significant legal costs and fees for the litigation. As with the Wausau Memo Account, CWS intends to eventually reconcile all amounts and request a disposition and closure of this account. As with the MTBE Memorandum Account, ORA disagrees with CWS's proposed application of litigation proceeds to only offset the capital costs of projects, with no litigation proceeds used to offset amounts for any incremental water treatment expenses.[44] However, unlike the MTBE Memorandum Account, ORA expects no adverse consequences to result therefrom because, as CWS explains, 100% of the litigation proceeds will be absorbed as CIAC to the benefit of ratepayers. Accordingly, CWS is not claiming the existence of any net proceeds to be split between shareholders and ratepayers after its investment in remediation facilities.

[44] CWS's 12/18/15 Response to JJS-013 (PCE MA) Final, states: "As with the MTBE litigation proceeds discussed in response to JJS-012, Cal Water will be proposing that all PCE litigation proceeds be applied as CIAC, which is only for capital costs." However, the Commission's Contamination Decision requires CWS to apply litigation proceeds towards all remediation costs that include both capital costs and expenses.

Therefore, the CIAC, which CWS expects to credit from litigation proceeds, will need to be allocated among the affected districts.[45] Therefore, ORA agrees with CWS's goal of achieving a fair and reasonable allocation among districts. This account should remain open, pending CWS's accounting and reconciliation.[46] ORA recommends approval of CWS's request to close this account after it finalizes the distribution of litigation proceeds in as timely a manner as possible via filing a Tier 3 Advice Letter or in CWS's next GRC.

12. Preliminary Statement W – Special Request: TCP Litigation Memo Account ("TCP MA")

This account shows a zero balance as of 6/30/2015. CWS reports that its litigation against parties potentially responsible for 1,2,3 trichloropropane (TCP) contamination remains stayed pending resolution of a number of earlier-filed TCP cases in a statewide coordination proceeding. CWS also updates the Commission, that discovery regarding the liability of defendants occurred, and expert testimony on common issues among the coordinated TCP cases was developed and that, currently, the court has allowed limited written discovery, but no trial date has been set. CWS expects a trial date within the next year.

CWS also anticipates that the State Water Resources Control Board, Division of Drinking Water, will issue a state maximum contaminant level ("MCL") for TCP in the upcoming year. The Company has expended consulting costs to address TCP contamination and future compliance with the MCL, as well as TCP treatment of certain wells in its Bakersfield District. Specifically, CWS states that it incurred consultant costs in 2012

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[45] CWS Response to JJS-013 (PCE MA) Final, p. 3.

[46] ORA requested additional information on CWS's PCE contamination remediation costs in ORA DR A1507015-JJS-013 (PCE Contamination Costs.)

and 2013 and that it is checking on the amounts of these costs and where they were booked. CWS explains that, if they were expensed, they are no longer available for recovery through the memo account because they were included in historical costs used for ratemaking in the 2015 GRC Application. CWS further explains that, if these costs were coded to a capital project, there is consequently no revenue requirement to track in the memo account because no capital TCP projects have been completed. In either event, CWS states that it can report on them for informational purposes, but does not consider them to be in the memo account.[47]

CWS states that, due to the large number of TCP-affected wells and the complexity of treating TCP, the Company's management is now preparing to treat TCP contamination. CWS states that, although potential TCP projects have been included in the Capital Justification Books for Bakersfield, Selma, and Visalia, nevertheless, CWS has not included capital dollars in its proposed Rate Base. CWS proposes a modification to Preliminary Statement W so that, once an MCL is adopted and CWS completes necessary capital projects that can be tracked in this memo account, CWS can consider seeking cost recovery as individual projects are completed.

ORA does not oppose CWS's proposed modification to Preliminary Statement W that would allow CWS to seek cost recovery as individual projects are completed. Nevertheless, CWS should record and report all TCP costs and litigation proceeds in a single, coordinated filing to help ensure the fair allocation of proceeds among the affected districts if necessary.

CWS states that it has incurred various expenses for TCP-related activities, however it has not reflected them in the memo account because they have been included in

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[47] CWS Response to ORA DR A1507015-JJS-014 (TCP Contamination Costs), p. 3.

forecasted expenses. Expenses that CWS can forecast do not qualify for Memorandum Account treatment. As with MTBE Contamination issue, CWS plans to only apply litigation proceeds to capital projects, not to incremental TCP-related treatment expenses.[48] CWS's proposed use of litigation proceeds to offset only capital costs is inappropriate because this practice does not conform to the Commission's definition of "net proceeds" in D.10-12-058. The Commission requires CWS's use of litigation proceeds to offset *all* remediation costs, both capital and expense if the amount of litigation proceeds is sufficient to do so.

ORA recommends that this account remain open as CWS requests, pending the adoption of a TCP MCL, completion of the TCP litigation, and remediation of damages as the Commission requires in D.10-12-058. The Commission should consider CWS's request to dispense with the account after CWS has completed all of these steps and has finalized the necessary accounting and reconciliation of costs and litigation proceeds. CWS should either file its reconciliation of this account via a Tier 3 Advice Letter or in a future GRC.

13. Preliminary Statement X – Operational Energy Efficiency Program Memorandum Account ("OEEP MA")

CWS requests implementation of surcharges to recover the carrying costs of the Operational Energy Efficiency Program Memorandum Account (OEEP MA) in the amount of $185,769 (as of 6/30/15) for OEEP projects via a Tier 1 advice letter. CWS informs the Commission that the 2012 Settlement authorized CWS to file a Tier 3 advice letter to close the OEEP MA, which contains the carrying costs associated with three capital projects in the Bakersfield, Chico, and Visalia Districts that CWS now believes to

[48] Id.

be used and useful. CWS explains that it has not filed that advice letter, and proposes to include the capital projects tracked in the OEEP MA in Rate Base.

However, as a result of its review of capital projects for Test Year 2016, ORA does not recommend approval of CWS's request to include CWS's OEEP costs in Rate Base.[49] Accordingly, ORA does not recommend approval of the carrying cost of these three capital projects in Rate Base. CWS should close the OEEP MA and charge the associated costs below-the-line.

14. Preliminary Statement Z1 – Conservation Expense Balancing Account 1 ("CEBA1")

As of June 30, 2015, the credit balance of the CEBA1 is $655,619. CWS reports that it filed AL 2122 to return to ratepayers $6,301,913 in conservation dollars authorized in the 2009 GRC that it had not spent in 2011-2013. ORA recommends approval of CWS's request to close this account as of 12/31/16, transferring residual amounts to the General District Balancing Accounts.

15. Preliminary Statement Z2 – Conservation Expense Balancing Account 2 ("CEBA2")

As of 6/30/2015, the CEBA2 MA had a credit balance of $3,975,438. Like CEBA 1, the Commission authorized a conservation budget for the GRC period of 2014-2016, and a one-way balancing account to track unspent amounts that must be returned to ratepayers. In 2014, the approved conservation budget associated with this memo account was $6,999,757, while CWS had $4,337,628 in expenditures, thus for the year of 2014 there was a balance of $2,688,762 to potentially return to customers. CWS proposes

[49] See ORA's Report on Plant – Common Issues.

amortizing any remaining balance after the 2014-2016 GRC period is over. ORA agrees with this approach because CWS could spend additional amounts between now and the end of 2016. The CEBA 2 should remain open through 2016, and be closed after CWS files a Tier 3 Advice Letter, in order to reconcile the one-way balancing account for the 2014-2016 period.

16. Preliminary Statement AA1 – Pension Cost Balancing Account (PCBA1)

The remaining balance of the PCBA1 as of 6/30/15 is $1,872,065. The Pension Cost Balancing Account ("PCBA") allows that the recording amounts in the balancing account limited to the difference between CWS's SFAS 87 costs allowed for ratemaking purposes, which are based upon CWS's actuarial estimate, and recorded expenses. CWS must also prove the reasonableness of any change in accounting in a general rate case proceeding.

The PCBA is a two-way balancing account in which under-recovery of actual costs may be collected through a surcharge, and over-collected costs must be returned to ratepayers.

In A.12-07-007, ORA verified the balance in the account as $1,673,629 as of August 31, 2012. The parties agreed in a settlement adopted in D.14-08-011 that CWS could amortize the PCBA for 2011-2013 via a Tier 1 advice letter within 120 days of the Commission decision. With the adoption of another "pension cost balancing account" for the 2014-2016 GRC period, the parties also agreed to distinguish between the two pension cost balancing accounts by changing the nomenclature so that account authorized in the 2009 GRC is "PCBA1" with a preliminary statement of "AA1," and the account authorized in the 2012 GRC is "PCBA2" with a preliminary statement of "AA2."

As of December 31, 2013, actual vs. allowed pension costs resulted in a balance of $3,007,305 in the PCBA1. CWS allocated this balance to each of its Class A-regulated ratemaking areas, and requested amortization over 12 months in Advice Letter 2153 on December 12, 2014. Customers are now being charged a fixed monthly surcharge that varies by district for January 29, 2015 through January 28, 2016. CWS plans to transfer any residual amounts to the District BAs for further amortization. ORA agrees with

CWS's proposal. This account should be closed effective 1/29/16 with any remaining balances transferred to the General District Balancing Accounts.

17. Preliminary Statement AA2 – Pension Cost Balancing Account 2 ("PCBA2")

As of 6/30/15, the balance of the PCBA2 was a net credit of ($2,340,643.) As noted in the previous section, in the 2012 GRC, the Commission authorized pension expenses for the total three-year GRC period of 2014-2016, as well as a two-way balancing account that mirrors that authorized in the 2009 GRC. In 2014, authorized vs. actual pension expenses resulted in a balance of $4,290,979 owed to ratepayers. CWS proposes to amortize the remaining balance in this account after the 2014-2016 GRC period, and ORA agrees with this approach.

However, ORA expects that the current over-recovery will be larger after CWS corrects at least two errors in its method of calculating the balance in this account. According to the Commission's Rate Case Processing Plan, Balancing Accounts are not subject to escalation. However, in its Escalation Filings, CWS has applied escalation factors to the amount of Pension Expenditures, contrary to Commission Escalation Procedures. The Commission should require CWS to exclude pensions from escalation calculations in future escalation filings. However, because CWS has erroneously requested and received escalation increases for Pension Expenses, when it calculates the Balancing Account to correct for this, it should reflect the resulting escalation revenue increase as an increase to "Authorized Expenses." Increasing Authorized Expenses for CWS's escalation in previous Advice Letters will correctly reflect CWS's additional revenue recovery for Pension Expenses, contributing to a lower net balance. Accordingly, Pension Expense escalation increases will increase the amount of Pension Costs recovered through rates. CWS should address these calculation differences when it files for revenue recovery of this account upon completion of the current GRC cycle on 12/31/16.

Similarly, ORA also takes issue with CWS's application of capitalization ratios to Pension Expenses. In calculating Pension Expenses, CWS should use capitalization ratios that are consistent with those assumed in CWS's Test Year 2014 GRC. By altering the capitalization ratio, CWS could experience either a windfall or shortfall, thus working contrary to the intended purpose of the Balancing Account. A change in capitalization ratio amounts to a change of accounting policy. Under the terms of the Balancing Account, CWS should not change its accounting policies, of which the capitalization ratio is one. For purposes of calculating the recovery of Pension Expense, CWS should use the same capitalization as the Commission assumed when it adopted CWS's Pension Expense in the GRC. This issue should be also addressed when CWS files for revenue recovery of this account, which is expected sometime after 12/31/16.[50] Prospectively, CWS should not apply escalation to amounts included in Balancing Accounts. If CWS nevertheless does apply escalation to Pension Expenses, it should conform its calculations supporting its request for Balancing Account recovery to use the same capitalization ratios as those adopted in CWS's last GRC, even if CWS has changed the capitalization ratios it uses for accounting purposes.

18. Preliminary Statement AB2 – Health Cost Balancing Account ("HCBA2")

The balance in the HCBA2 was $2,468,803 as of 6/30/2015. In the 2012 GRC, the Commission authorized health care expenses for the GRC period of 2014-2016, and a two-way balancing account to track 85% of the difference between authorized and actual health care costs over the period. CWS reports that, in 2014, 85% of the difference resulted in a balance of $1,074,769 to be recovered from ratepayers. CWS proposes to amortize the remaining balance in this account after the 2014-2016 GRC period is over, and ORA agrees with this approach. However, ORA notes a few exceptions:

a. Preliminary Statement AB2 defines the scope of this Balancing Account as:

[50] ORA requested CWS to re-calculate its Pension Cost Balancing Accounts to correct for these exceptions in ORA DR A1507015-JJS-009 (BAs) and ORA DR A1507015-JJS-010 (BAs - Capitalization Ratios). CWS has informed ORA that preparation of CWS's Responses to these Data Requests will require it to conduct extensive, time-consuming research. CWS's Responses are still pending.

> The purpose of the Health Cost Balancing Account (HCBA2) is to track the difference between the adopted health care expenses (including post-retirement benefits other than pension or PBOB) and *the total actual cost incurred as health care expenses*. (*Emphasis added.)*

However, CWS disclosed the following costs that it had recorded in this Balancing Account as health care costs, even though they appear to fall outside the defined Scope of the Memorandum Account:

- Repricing and Investigation Fees;
- Service and Risk Management Fees; and
- Administrative and Audit Fees.

Initially, ORA questioned whether CWS should exclude from its HCBA all costs of "Repricing and Investigation Fees, Service and Risk Management Fees, and Administrative and Audit Fees" because they appeared to be Administrative and General Expenses and not true Health Care Expenses. ORA notes that the Commission expressed its concerns in D.03-06-072 that costs booked to a Balancing Account should match the actual costs that the Commission has authorized the utility to track in the account. [51]

In its Data Response, CWS explains that these costs are actual costs against which the adopted expenses will be compared. Moreover, CWS incurred approximately half of these costs, or $500,000, to investigate lower cost health care alternatives, and the other half represents normal administration and audit expenses. CWS states that, as a result of these consulting services, CWS prospectively anticipates realizing significant savings. ORA therefore, accepts these costs.

[51] By 1975, it became clear that the fuel clause was producing distorted results. Instead of reimbursing the utilities for their actual fuel costs, the clause produced a windfall for the utilities that bore no relation to actual expenses.

b. Similar to ORA's concerns expressed above for CWS's Pension Expense Balancing Account, ORA, disagrees on two points with CWS's method of calculating the balances in this account:

<u>Escalation of Expenses</u>: In its 2015 and 2016 Escalation Filings, CWS has applied escalation factors to its Health Care Expenditures, contrary to Commission Escalation procedures, which specify that Balancing Accounts are not subject to escalation. The Commission should require CWS to exclude health care expenditures from the escalation calculation going forward. However, because CWS has nevertheless, requested and received escalation increases for Health Care Expenditures, it must reflect the resulting revenue increase as additional amounts of "Authorized Expenses" because CWS's escalation provided additional revenue recovery offsets for Health Care Expenditures. When CWS files for recovery of these Expenses, it should reflect any escalation applied to this Expense as increases in Authorized Expenses, thus helping to offset the amount of actual expenses incurred. CWS should address these calculation differences when it files for revenue recovery for this account after 12/31/16

<u>Inconsistent Capitalization Ratios</u>: ORA also takes issue with CWS's application of capitalization ratios to Health Care Expenditures. In calculating Health Care Expenses, CWS should use capitalization ratios that are consistent with those assumed in CWS's Test Year 2014 GRC. By altering those ratios, CWS may experience either a windfall or shortfall, thus defeating the purpose of the Balancing Account. Under the terms of the Balancing Account, CWS must justify any changes in its accounting policies, and the selection of a capitalization ratio is one of CWS's accounting policies. This issue should

be addressed when CWS files for revenue recovery of this account, expected after 12/31/16.[52]

Prospectively, ORA recommends that CWS: 1) Exclude from its Health Care Cost Balancing Account any costs that are not Health Care Expenses; 2) Not apply escalation to amounts subject to Balancing Accounts. If it has applied escalation in its Escalation Filings, CWS must increase the amount of "Authorized Expenses" used in its calculations to reflect the amount of additional revenue recovery resulting from CWS's application of escalation factors; and 3) Conform its calculations supporting its request for Balancing Account recovery to use the same capitalization ratios as those adopted in CWS's last GRC, even if CWS has changed the capitalization ratios it uses for accounting purposes.

19. Preliminary Statement AC – Pressure Reducing Valve Modernization and Energy Recovery Memo Account ("PRVMA")

CWS reports that there is no balance in this account because the capital projects that may be tracked in the PRVMA have not yet been completed. When the projects are completed, the carrying costs of those projects will be recorded in the PRVMA. However, Preliminary Statement AC states that "[t]he purpose of the PRVMA is to record *all the costs associated with the research, development and demonstration of the electrical regenerative flow control valve projects*." (*Emphasis added*.)[53] ORA inquired

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[52] ORA requested CWS to re-calculate its Health Care Balancing Account to correct for these exceptions in ORA DR A1507015-JJS-009 (BAs) and ORA DR A1507015-JJS-010 (BAs - Capitalization Ratios). CWS requested additional time to prepare its Response due to the extensive research required to respond to these requests and CWS's Responses are still pending.

[53] Preliminary Statement AC, p. 1.

regarding the apparent inconsistency between the Preliminary Statement and CWS's reflecting a zero balance.[54] CWS responded:

> Having a Zero Balance in the PRVMA – In general, Cal Water only keeps track of costs for memo account treatment if there is a possibility of recovery – expenses or carrying costs. The investment costs associated with a project are not recovered in a memo account; it is the revenue requirement that is recoverable. Therefore, if there is possible recovery of both expense and capital costs through a specific memo account, Cal Water's practice is to track the expenses and, after a project closes, track the revenue requirement (with subsequent carrying costs) from the date the project is "closed to plant."
>
> In the case of the PRVMA, the costs that have been incurred for PID 65566 are of the type that typically can be capitalized when the project is closed to plant. There are no costs of the type that are typically expensed. For the reasons discussed above, Cal Water does not consider the investment capital itself to be recoverable through the memo account; therefore, in the absence of both expenses and a closed capital project, Cal Water has considered the "balance" in this account to be zero.[55]

ORA is aware that CWS does not have to include capital costs in its Memorandum Accounts. With the exception of any associated carrying costs incurred between the in-service date and the date of the capital costs' inclusion in the first year's Rate Base, CWS can prospectively recover adopted capital costs in a future Test Year Rate Base without violating the Commission's ban on retroactive ratemaking. Because CWS may use this account to track carrying costs associated with the construction of PRVs, this account

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[54] ORA DR A1507015-JJS-016 (Pressure Reducing Valve Memorandum Account), sent 12/4/2015.

[55] CWS Response to ORA DR A1507015-JJS-016 – PRVMA, p. 5.

should remain open pending CWS's completion of construction of PRV projects and its future request for ratemaking recovery of associated Revenue Requirements.

20. Preliminary Statement AD – Stockton East Litigation Memo Account ("SLMA")

The SLMA has a balance of ($400,272) as of 6/30/2015. CWS states that it incurred approximately $42,675 in expenses for the Stockton East litigation prior to the effective date of this account, April 21, 2011. Subsequently, CWS has incurred additional legal expenses, but has also received a confidential settlement amount, as a credit to ratepayers, not including overpayments to the Stockton East Water District (SEWD) that are part of purchased water costs for the Stockton District. CWS further reports that the dollar amount that can be considered an "overpayment" is in dispute, and will be resolved in a lawsuit that is still outstanding.

This Memorandum Account should remain open to track: 1) Actual legal costs; 2) Monetary judgment or settlement; 3) Costs/judgments/settlements in forecast for legal expenses; and 4) Overpayments to SEWD in accordance with Preliminary Statement AD. After CWS has resolved all disputes and determines the amount of net proceeds, CWS should request amortization of the net balance to CWS's Stockton District ratepayers, including the refund as a reimbursement for any overpayments, and close this account via a Tier 3 Advice Letter or in CWS's next GRC.

21. Preliminary Statement AE – 2010 Tax Law Memo Account ("2010 Tax MA") (for Bonus Depreciation)

CWS has calculated that $1,840,467 (the balance as of 6/30/2015) is owed to ratepayers, and requests authority to amortize this amount through a Tier 1 advice letter. CWS reports that the Commission ordered the creation of this account in Resolution L-411-A on June 23, 2011. CWS added Preliminary Statement AE to its tariff in AL 2047-A, and subsequently modified it in the 2012 GRC to reflect an extension of this tax benefit through the end of 2013. The Commission should approve CWS's request to amortize the balance in this account as of 12/31/16 by filing of a Tier 1 Advice Letter. CWS should subsequently close this account. See ORA's *Companywide Report on the Results of Operations*, for a discussion of CWS's Bonus Tax Depreciation calculations.

22. Preliminary Statement AG – Catastrophic Emergency Memo Account ("CEMA")

CWS reports that it has not experienced any events that have required the use of this account. Nevertheless, in compliance with PUC Section 454.9, the Commission has authorized a CEMA for all Class A water utilities and ORA recommends that CWS's CEMA remain open.

23. Preliminary Statement AI – Chromium 6 Memo Account ("Cr6 MA")

The Cr6 MA had a balance of $18,223 as of 6/30/2015. CWS reports that it monitors costs that may be appropriate to include in this memo account. CWS warns, however, that amounts monitored are subject to change, because the "balance" at any point in time can vary based upon whether the appropriate product and class codes are used consistently, whether vendors are timely in invoicing CWS, and whether internal processing of invoices goes smoothly. CWS concludes that the amount currently monitored for the Cr6 MA for possible expense recovery, the current balance of $18,223, is subject to review to ensure that they are not embedded in current or forecasted rates. CWS is also monitoring the costs incurred for several capital projects, with $116,087 costs associated with projects currently completed and in service. CWS says that the carrying costs for these capital projects can be tracked in the Cr6 MA for potential recovery (subject to confirmation that they have not been included in the beginning plant balances). More significantly, CWS reports that there are over $7 million in capital costs incurred for chromium-6 projects that are still in progress that appear to meet the criteria for this account. ORA's goal is to avoid duplicating entries to this account that are already included in Plant in Service beginning balances for Test Year 2017. Nevertheless, CWS informed ORA that CWS does not propose adding any Chrome 6 capital projects for any district to Rate Base in this GRC; rather, CWS will account for them in the Cr6 MA. This account should remain open, reduced for any related amounts added to Rate Base (subject to reasonableness reviews), and offset by crediting CIAC for any grant money received.

24. Preliminary Statement AJ – Low Income Ratepayer Assistance Balancing Account ("LIRA BA")

The LIRA BA had a balance of $2,449,181 as of 6/30/2015. This account tracks the actual funding (i.e. from all of the surcharges collected from non-LIRA customers) and expenses (i.e. credits given to LIRA customers) of the program. The LIRA surcharge is a percentage of the base bill (service charge and quantity charges) of non-LIRA customers. CWS notes that this surcharge is recalculated each year to true up the balance in the account, and to reflect the LIRA benefits that will be given the following year. The LIRA surcharge was adjusted to 2.857% on January 1, 2015. The next adjustment will be effective January 1, 2016. ORA recommends approval of CWS's proposal to re-calculate the surcharge effective 1/1/16.

25. Preliminary Statement AK – 2012 Interim Rate Memorandum Account ("2012 IRMA")

As of June 30, 2015, the 2012 IRMA contained a balance of $20.2 million still to be recovered from ratepayers. CWS notes that, in July 2012, CWS filed a general rate case application (A.12-07-007) for new rates in its 23 regulated districts for the period of 1/1/2014 through 12/31/2016. On 10/30/2013, CWS filed a motion for interim rates because it appeared unlikely that the Commission would issue a final decision prior to the 1/1/2014 effective date for new rates, and requested an interim rate memorandum account.

CWS proposed that, beginning 1/1/2014, CWS would continue to bill customers the rates that were in effect as of 12/31/2013 as "interim" rates. The proposed memo account would track the difference between the rates billed to customers between 1/1/2014 and the date that new rates are implemented ("Interim Period"). After the Commission issued a decision with new rates, CWS would request implementation of the new rates, and would specify the effective date of the modified tariff. The effective date of the tariff with the new rates would trigger the end point of the "Interim Period."

The Commission resolved the proceeding in D.14-08-011 on 8/14/2014, with adopted new rates effective back to the first day of the new Test Year, 1/1/2014. CWS filed Advice Letter 2140 with an effective date of 9/30/2014 to begin amortizing the 2012 IRMA. Due to the magnitude of their percentage increases, many of these surcharges have a duration extending 2-3 years.

Because there are significant remaining balances to be recovered from customers in the 2012 IRMA as CWS continues to amortize this account, it should remain open for the duration of their surcharges and credits, with any residual balances remaining upon their expiration transferred to the General District Balancing Accounts. At that time, CWS should close the IRMA.

26. Preliminary Statement AL – Special Request: Drought Memo Account ("DRMA")

CWS reports a balance in the Drought Memo Account as of June 30, 2015 of $1,483,656 in expenses. CWS reports that the Drought Memo Account was authorized in Resolution W-4976 on February 27, 2014. CWS added Preliminary Statement AL to its tariff effective May 1, 2014 through Advice Letter 2124. CWS requests amortization of this amount via a Tier 1 advice letter. In addition, as discussed in CWS's Testimony on Special Requests, CWS requests Tier 2 amortization of any balance in the account up to December 31, 2015, and the opportunity to amortize DRMA balances going forward on an annual basis via a Tier 2 advice letter.

ORA notes that a significant amount of the expenses booked to this account are labeled as "Payroll Expenses." ORA seeks to ensure that expenses recovered through the DRMA do not duplicate normal operating payroll expenses already provided for in CWS's rates. Accordingly, ORA issued a data request[56] for additional information on this account. CWS informs ORA that it is currently reviewing its accounting of DRMA costs and its Response to ORA's Data Request is still pending. This account must remain open, pending: 1) CWS's completion of its accounting review of the DRMA; 2) The Governor's announcement of the official end of the drought period; and 3) CWS's de-activation of its Schedule 14.1, Rule 14.1, and Stage 3 - Critical Water Reduction of that Rule in order to meet CWS's state-mandated water use reduction goal. CWS should file a Tier 3 Advice Letter for dispensation and closure of this account when CWS has completed its verification or address its reconciliation and closure of this account in CWS's next GRC.

27. Preliminary Statement AM – Special Request: Rate Support Fund Balancing Account ("RSF BA")

As of June 30, 2015, CWS reports that the balance in the RSF BA to be recovered from ratepayers was $ 424,236. ORA notes that the RSF BA tracks all of the credits given to customers in RSF areas, and all of the surcharges collected from all customers (except LIRA customers in RSF districts) to fund the program.

CWS says that it has not recalculated the RSF surcharge that would be needed to recover the existing RSF balance, and RSF funding needs in the 2017-2019 rate case period because of the uncertainties in this proceeding about the continuation of the RSF. CWS proposes in its Special Request Testimony (SR #1) the consolidation of several districts

[56] ORA DR A1507015-JJS-008 (DRMA), Sent 11-16-15.

into regional districts, accompanied by a gradual diminishment of the RSF program as regional rates align towards a consolidated tariff. CWS, however does not provide any details concerning a phase down of the RSF. As noted in ORA's Testimony on Special Requests #1 and 2 (District Consolidation and RSF Phase-Down), ORA does not recommend the Commission's approval of CWS's proposed consolidation of districts. In lieu of consolidation, ORA proposes to update and to modify the RSF Program's subsidy methodology.

ORA recommends approval of CWS's request to recalculate the RSF surcharge in the same manner that it re-calculates the LIRA surcharge. Concomitantly, ORA also recommends modifying the RSF subsidy methodology, as further explained in Chapter 1 of this Report. CWS should file a Tier 2 Advice Letter to recover any RSF balance remaining as of 12/31/2016 via a one-time surcharge. CWS should request a new surcharge, re-calculated for Test Year 2017, reflecting any adopted changes to the Program that will affect RSF funding requirements. With each annual filing to update the RSF surcharge, CWS should concomitantly re-calculate the subsidy levels for each district, based on the then-current rates. In addition, effective 1/1/2017, ORA recommends approval of CWS's request to annually true-up this account via the same mechanism currently used for the LIRA Balancing Account, which the Commission approved in D.12-09-020.

28. Preliminary Statement AN – Infrastructure Act Memo Account ("Infra MA")

Since 2011, CWS has sold real property previously included in rates, has tracked the transaction costs, and calculated the net gain (or loss) on the sales, consistent with D.06-05- 041, D.06-12-043, and Preliminary Statement AN. For the period of 2012-2014, the net gain in sales was $81,222 in 2012 and $51,148 in 2014. CWS's reinvested funds significantly exceeded the amounts of gain on disposition of property each year. The balance in this account is therefore zero. ORA has no issue with this account because it is informational only and the annual amounts of gains reinvested in plant have historically exceeded the amounts of total gains on sales of property.

29. Preliminary Statement AO – Water Contamination Litigation Memo Account ("WCLMA")

CWS reports that it has not experienced any events that have required the use of this account. This is a generic Memorandum Account authorized for all water companies in Resolution W-4094, and it should remain open.

30. Preliminary Statement AP – General District Balancing Accounts ("Dist BAs")

As of June 30, 2015, the total net balance in the Dist. BAs was $524,271. The Commission approved these Balancing Accounts, one for each district, with an effective date of September 25, 2014. As authorized in Ordering Paragraph 22 of D.14-08-011, CWS transferred the balances of several accounts with residual amortizations to the District BAs. CWS filed AL 2153-A on January 22, 2015 requesting amortization of the District BAs. On January 29, 2015, CWS began a 12-month amortization of the balances through surcharges and credits, which varied by district, for a total net collection of $736,323. These accounts should remain open to accommodate the dispensation of residual balances, as discussed for several Balancing Accounts in this Report.

31. Preliminary Statement AQ – East Los Angeles Memo Account ("ELA MA")

As of June 30, 2015, the total net balance in the ELA MA was $1,624,535. CWS reports that the origin of the East Los Angeles Memo Account is described on pages 227-230 of the 2012 GRC Settlement Agreement approved in D.14-08-011. In brief, CWS and ORA disagreed on the appropriateness of CWS's purchase of certain land in its East Los Angeles District to construct groundwater wells, as well as improvements made to an existing building on the property to house the district's customer service operations (commonly referred to as the "Tubeway" property and projects.)

After negotiations, the parties agreed that certain costs could be included in rate base, and certain costs should be held in the East Los Angeles Memo Account ("ELA MA"):

The capital costs for the projects allowed in the ELA MA, total $4,646,626. CWS has calculated the carrying costs (the return on investment, ad valorem taxes, and depreciation) for this amount to be $1,627,008 for the period of January 1, 2014 through December 31, 2016.

CWS says that, in the Capital Project Justification Book for the East Los Angeles District, CWS has provided explanations and support for why the projects in the ELA MA should be allowed into rate base in this GRC. ORA, however, does not recommend approval of CWS's request to include the cost of the East Los Angeles Memorandum Account projects in Rate Base.[57] Accordingly, ORA does not recommend approval of any capital or carrying costs for this Memorandum Account because CWS has not provided sufficient justification and, accordingly, this account will remain open.

32. Preliminary Statement AS – Asbestos Litigation Memo Account ("ALMA")

CWS reports an ALMA balance of $ 73,118 in litigation fees and expenses, as of June 30, 2015. CWS reports that, in D.14-05-045, the Commission approved a settlement between CWS and ORA allowing the creation of the Asbestos Litigation Memo Account to track litigation and related amounts for lawsuits brought against CWS alleging asbestos exposure.

CWS offers to verify this balance before any request for amortization. Pending ORA's review of CWS's verification, this account should remain open. CWS should file a Tier 3 Advice Letter for dispensation and closure of this account when CWS has completed its verification or address its reconciliation and closure of this account in CWS's next GRC.

[57] See ORA's Report on Plant – Antelope Valley, Dominguez, East Los Angeles, Hermosa-Redondo, Palos Verdes and Westlake Districts.

33. Old Interim Rate Surcharge Residuals

The balance of the Old Interim Rate Surcharge Residuals Account was $1,161,591 as of 6/30/2015. CWS reports that it implemented an "interim rate surcharge" to effectuate the transition from one CWS rate case per year, to one consolidated rate case. The delay in the general rate cases for one group of districts was handled by allowing a surcharge for those districts for a set time period. There are now residual amounts for those districts, some of which are owed to customers and some that must be recovered from customers, resulting in a net credit of $1,161,591 owed to customers. CWS reports that these amounts are not part of a formally authorized memo or balancing account.

In this case, CWS should promptly seek the Commission's approval to amortize these amounts. CWS requests authority to transfer these positive and negative residual amounts to the General District Balancing Accounts that were authorized in the 2012 GRC. CWS should promptly seek Commission approval to amortize the amounts in these accounts.

E. CONCLUSION

With the exceptions noted above, CWS's memorandum accounts generally appear to be reasonable. Most of the accounts reviewed in this GRC will be closed after amortization, and Advice Letters filed with DWA to implement their respective surcharges and surcredits. In some cases, CWS's Preliminary Statements require monthly tracking of all costs, while CWS has been postponing recording any costs until CWS has completed projects. ORA recommends that CWS keep its accounting of memorandum accounts current. Failing that, ORA recommends that CWS provide the Commission with a complete reconciliation of the financial data recorded on its financial statements with those it provides the Commission for ratemaking purposes, clearly accounting for all adjustments resulting CWS makes for its Memorandum Account data. Finally, ORA recommends that all advice letter filings relating to these memorandum accounts be made by Tier 3 Advice Letters or in CWS's next GRC unless otherwise noted above, allowing CPUC staff the opportunity to verify and confirm the fairness and accuracy of CWS's requested rate adjustments.